

Pensions Board

Agenda

Wednesday 6 February 2019

7.00 pm

Committee Room 3 - Hammersmith Town Hall

MEMBERSHIP

Employer Representatives
Councillor Bora Kwon Councillor Rory Vaughan (Chair) Councillor Bora Kwon
Scheme Member Representatives
Eric Kersey Orin Miller Neil Newton

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Date Issued: 28 January 2019

Pensions Board Agenda

6 February 2019

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2. MINUTES OF THE PREVIOUS MEETING To agree the minutes of the meeting held on 27 June as an accurate record.	5 - 10
3. APOLOGIES FOR ABSENCE	
4. DECLARATIONS OF INTEREST <p>If a Councillor has a disclosable pecuniary interest in a particular item, whether or not it is entered in the Authority's register of interests, or any other significant interest which they consider should be declared in the public interest, they should declare the existence and, unless it is a sensitive interest as defined in the Member Code of Conduct, the nature of the interest at the commencement of the consideration of that item or as soon as it becomes apparent.</p> <p>At meetings where members of the public are allowed to be in attendance and speak, any Councillor with a disclosable pecuniary interest or other significant interest may also make representations, give evidence or answer questions about the matter. The Councillor must then withdraw immediately from the meeting before the matter is discussed and any vote taken.</p> <p>Where Members of the public are not allowed to be in attendance and speak, then the Councillor with a disclosable pecuniary interest should withdraw from the meeting whilst the matter is under consideration. Councillors who have declared other significant interests should also withdraw from the meeting if they consider their continued participation in the matter would not be reasonable in the circumstances and may give rise to a perception of a conflict of interest.</p> <p>Councillors are not obliged to withdraw from the meeting where a dispensation to that effect has been obtained from the Audit, Pensions and Standards Committee.</p>	
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6.	LOCAL GOVERNMENT PENSION SCHEME (LGPS) ADMINISTRATION PERFORMANCE UPDATE	24 - 30
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11.	PIRC ANNUAL REPORT	77 - 84
	The purpose of this paper is to update the Pensions Board on the investment performance of the fund during the financial year 2017/18.	
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	This paper provides the Pensions Board Members with a summary of the Pension Fund's overall performance for the quarter ended 30 September 2018.	
13.	GAD REPORT	134 - 185
	This report and appendices provide the Pensions Board with an update on the Government Actuary's Department's (GAD) report on the 2016 LGPS triennial actuarial valuation outcome	
14.	MHCLG CONSULTATION UPDATE	186 - 197
	The Pension Board is recommended to note the draft guidance on pooling and express any desired feedback for the consultation process.	

Agenda Item 2

London Borough of Hammersmith & Fulham

Pensions Board Minutes



Wednesday 27 June 2018

PRESENT

Committee members: Councillors Bora Kwon and Rory Vaughan

Co-opted members: Eric Kersey

Officers: Phil Triggs (Director of Treasury and Pensions), David Coates (HR and Payroll), Miriam Adams (Treasury and Pensions), and Amrita Gill (Governance).

1. APPOINTMENT OF CHAIR AND VICE CHAIR

RESOLVED:

That Councillor Rory Vaughan be appointed as the Chair of the Pensions Board for the 2018-19 municipal year.

The Pensions Board decided to defer the election of the Vice-Chair until the next meeting.

2. MINUTES OF THE PREVIOUS MEETING

The meeting held on 7 February 2018 was not quorate but an informal briefing session took place. Members noted the discussion held at this meeting.

3. APOLOGIES FOR ABSENCE

4. Apologies for absence were received from Mark Grimley, Neil Newton and Orin Miller.

4. DECLARATIONS OF INTEREST

There were no declarations of interest.

5. MINUTES OF THE PENSIONS SUB COMMITTEE

RESOLVED:

That the minutes of the Pensions Sub-Committee meetings held on the 21 November 2017 and 27 February 2018 were noted.

6. LONDON CIV UPDATE

Phil Triggs updated the Board and noted that Chris Bilsland, a non-executive director at London CIV (LCIV), gave a presentation to the Pensions Sub Committee on 27 February 2018. He outlined three key areas, which covered an operational and responsible investing update. Additionally, he showed slides that noted the future direction of travel of LCIV.

Phil Triggs said that the Sub-Committee were not satisfied with the answers provided by the LCIV as they didn't offer any reassurances. Additionally, the LCIV lacked resources and with no clear long-term business strategy in place it was evident that they would need to address the fundamental issues. The Sub-Committee agreed that if the Council gave up some degree of sovereignty in relation to the management of its pensions fund, then the governance of LCIV needed to be as robust and as democratic as possible.

RESOLVED:

That the Board noted the update as presented to the Pensions Sub Committee.

7. LONDON CIV GOVERNANCE REVIEW

Phil Triggs provided an update and noted that the original governance review carried out by Willis Towers Watson on LCIV wasn't complimentary of the way work had been carried out. The report made a number of recommendations for change and improvement in LCIV's governance arrangements and operating model. The key concern highlighted the engagement of a wide stakeholder base with conflicting priorities and managing these different groups to achieve joint outcomes. The Investment Advisory Committee (IAC) and the Joint Committee were not perceived to be operating optimally in their current form.

Following the concerns raised and feedback received from Local Authorities across London, LCIV had re-submitted a new governance report to streamline their processes. This included the creation of a Shareholders Committee that would report to the Board, with two non-executive directors to be appointed to the Board by London Local Authorities. Discussions of the memberships of these governance structures were ongoing with nominations to be presented at the annual general meeting (AGM) on 12 July 2018.

Councillor Rory Vaughan asked what the arrangements were for the new management structure going forward. Phil Triggs said that LCIV had delayed the recruitment of a Chief Investment Officer (CIO) pending the outcome of the AGM meeting. The current interim Chief Executive was well regarded and had brought some stability to the future direction of LCIV, however the future plan was unknown at this stage.

RESOLVED:

That the report was noted.

8. QUARTERLY UPDATE REPORT

Phil Triggs presented the report for the quarter that ended 31 December 2017. He noted that the scorecard in Appendix 1 provided a high-level view of the key

pensions issues and overall funding levels remained healthy. Over the 12-month period, the fund delivered a net return of 6.7%, underperforming the benchmark by 1.9%. However, the fund remained ahead of the benchmark over the three and five-year periods by 0.2% p.a. and 4.4% p.a. respectively.

Councillor Rory Vaughan, referring to page 56 of the agenda pack, asked why the net cash figures for April 2018 were higher than previous months. Phil Triggs explained that this was a result of the accruals from the last financial year as well as contributions received from other financial areas. Furthermore, the Council also paid their deficit at the end of the financial year. An analysis of the difference between the actuals and the forecast for the quarter were also shown, as well as an additional analysis of the invested cash in the Legal and General Investment Management (LGIM) sterling liquidity fund.

Phil Triggs noted that Appendix 4 showed the pensions fund risk register and there had been no changes this quarter. Councillor Rory Vaughan, referring to page 65 of the agenda pack, noted that risk 18 had a particularly high score and asked if there was a cause for concern. Phil Triggs explained that all the mitigating actions were in place and staff were obeying all the internal audit controls, therefore the risk needed to be reviewed. In addition, he noted that following a meeting with internal colleagues the risk register would be re-drafted to include a gross score and the likelihood of the risk. This would also include a series of mitigating actions and provide a net risk rating to ensure that all the appropriate safeguards were carried out. He noted that the risk register would be re-drafted to reflect these changes and brought to the next Pensions Board meeting.

Councillor Rory Vaughan, referring to page 61 (risk 9) of the agenda pack, asked if all mitigating actions were achieved and as a result had reduced the risk. Phil Triggs noted that fund managers were engaging with fund managers to understand the position better in relation to MiFID II and members were up-to-date with the relevant training. In addition, pensions fund officers maintained links with central government and national bodies and regularly met with fund managers to discuss their processes. He noted that this risk would be reduced for inclusion at the next meeting.

RESOLVED

That the report was noted.

9. ADDITIONAL VOLUNTARY CONTRIBUTION PROVIDER TRANSITION UPDATE

Phil Triggs gave an overview and noted that the report provided an update of the AVC provider, Zurich Corporate Savings, transitioning their existing portfolio of Hammersmith and Fulham (H&F) pension fund member assets to a new platform. The transition aimed to provide members with a better service by utilising an online platform where members can check their benefits and receive up to date information. The implementation would require key contributions from Human Resources in communicating this change to affected members.

Between February-May 2018 regular joint consultations occurred between Zurich and officers representing the shared services treasury team and the shared services

retained pensions team to ensure that the transition occurred smoothly and that target dates in the project were met. There had been no complaints from the scheme members relating to this transition.

RESOLVED

That the Pensions Board noted the update as presented to the Pensions Sub Committee.

10. LOW CARBON STRATEGY UPDATE

Phil Triggs provided an overview and noted that the paper updated the Board on the funds current approach to fossil fuel investment and any possibilities of divestment in the future. The Pensions Sub Committee was recommended to join the Local Authority Pension Fund Forum (LAPFF), as doing so would allow the Council to engage and support the work of the organisation to ensure better environmental, social and governance decisions were taken within its portfolio. The report would be re-drafted and presented at the next Pensions Sub Committee, to discuss options in more detail and a decision would be made on how to proceed.

He highlighted that the Sub-Committee held a key fiduciary responsibility to manage the fund's investments in the best interests of the beneficiary members and the Council tax payers, where the primary focus must be on generating an optimum risk adjusted return. In addition, it was vital that any investment decisions or strategies developed, such as carbon strategy, did not negatively impact on this primary responsibility.

RESOLVED

That the Pensions Board noted:

1. The recommendations approved by the Pensions Sub Committee and,
2. The Pensions fund's current approach to fossil fuel investing.

11. PENSION FUND ADMINISTRATION UPDATE

David Coates (HR and Payroll) provided a verbal update on the performance of the Surrey County Council (SCC) pension administration services for the period January to March 2018. He also circulated a report detailing Surrey County Council's performance against their agreed service levels. Surrey help desk received over 500 queries per month and over 90% were resolved by the help desk at first point of contact, which was high. In instances where SCC had initiated and maintained the pension record, performance targets had been reached in most cases.

Data inaccuracies inherited from Capita still impacted upon SCC performance, this was evidenced by the 'statements sent to member following receipt of leaver notification', which was below target. A target driven project plan to check and improve inherited data inaccuracies had been agreed with SCC and was monitored monthly by the shared services Retained Pensions Team. It had been brought to the attention of SCC that pension fund Transfers Out performance needs to be a priority for improvement. This would be discussed at the next quarterly service review

meeting so that a plan was put in place to bring performance to an acceptable standard.

There had been some delays in the processing of claim forms, which was because the information sent to SCC was incorrect. This meant that the target may need to be reviewed going forward. The score for the deferred benefits statements sent to members following receipt of leaver notification was still low due to inherited data errors from Capita. In addition, it would take up to a year to fix this and for it to reach a score of 80-90%. There had been no formal complaints received in the last quarter on Surrey's performance and feedback from scheme members remained very good.

David Coates said that overall, Surrey's performance was deemed acceptable in all areas with the exception of transfers-out of a scheme member's accrued pension cash value to another Local Government Pension Schemes (LGPS) employer. Councillor Rory Vaughan thanked David Coates for providing an update on the performance. He also suggested that the target be lowered on areas where 100% score was not achievable. David Coates advised that we continued to push them to improve on areas where they were not performing as well, however acknowledged the good work and efforts made by SCC.

Councillor Bora Kwon asked if SCC were complying with General Data Protection Record (GDPR) framework and if the Council was satisfied with the transition. David Coates said that SCC provided this service for the Council and other London boroughs. Their compliance documents would be made available on the website in August 2018. Furthermore, there had been no enquiries from scheme members in relation to compliance and there was no evidence to suggest data breaches and non-compliance.

12. EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED

That under Section 100A(4) of the Local Government Act 1972, that the public and press be excluded from the meeting during the consideration of the following items of business, on the grounds that they contain the likely disclosure of exempt information, as defined in paragraph 3 of Schedule 12A of the said Act, and that the public interest in maintaining the exemption currently outweighs the public interest in disclosing the information.

13. LONDON CIV UPDATE - EXEMPT ELEMENTS

The exempt elements of the report were noted.

14. LONDON CIV GOVERNANCE REVIEW - EXEMPT ELEMENTS

The exempt elements of the report were noted.

Meeting started: 7:00pm
Meeting ended: 8:00pm

Chair

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Agenda Item 5



London Borough of Hammersmith & Fulham

Pensions Sub-Committee Minutes

Tuesday 4 September 2018

PRESENT

Committee members: Councillors Iain Cassidy, Asif Siddique and Matt Thorley

Co-opted members: Michael Adam

Officers: Phil Triggs (Director of Treasury and Pensions), Timothy Mpofu (Pension Fund Manager) Sian Cogley (Finance Graduate Trainee) and Amrita Gill (Committee Co-ordinator)

Guests: Kevin Humpherson (Deloitte) Jennie Baruxakis and Aled Jones (FTSE Russell)

1. MINUTES OF THE PREVIOUS MEETING

RESOLVED

The minutes of the meeting held on 23 July 2018 were approved and signed by the Chair.

1. MINUTES OF THE PREVIOUS MEETING

RESOLVED

The minutes of the meeting held on 23 July 2018 were approved and signed by the Chair.

2. APOLOGIES FOR ABSENCE

Apologies for absence were received from Councillor Rebecca Harvey and Matthew Hopson (Strategic Investment Manager, Pensions)

3. DECLARATIONS OF INTEREST

There were no declarations of interest.

4. DRAFT PENSIONS BOARD MINUTES

The minutes of the meeting held on 27 June were noted.

Minutes are subject to confirmation at the next meeting as a correct record of the proceedings and any amendments arising will be recorded in the minutes of that subsequent meeting.

5. PENSION FUND QUARTERLY UPDATE PACK

Kevin Humpherson (Deloitte), presented the report for the quarter ending 30 June 2018. He noted that there were no significant changes to report and welcomed any questions from the Committee.

Michael Adam asked why the Partners Group – multi asset credit fund had underperformed. Kevin Humpherson said that this was predominately due to timing and explained that the Fund's 3-year investment period ended in July 2017, therefore any investments released had been repaid to investors. As a result, the distribution rate had increased over the last year with two further distributions made during the second quarter to June 2018. There were no further risks associated with this fund and overall Deloitte were satisfied with the Fund's mandate.

Councillor Matt Thorley asked for further clarification around the current position of the M&G – inflation opportunities fund. In response Kevin Humpherson explained that the Fund's yields had fallen significantly and the manager was expecting to increase the exposure to long lease property, therefore this had created an overlap with the Fund's long lease property mandate with Standard Life Investments. Based on the difficulties associated with the Fund, he advised that the Committee may wish to consider whether there were options for all or part of the Fund's allocation which offered at least a degree of "inflation proofing". The Chair requested that officers explored alternative opportunities and for a report to be brought to the next meeting.

Action: Phil Triggs

RESOLVED

That the Sub-Committee noted the report.

6. CARBON EXPOSURE AND EQUITY STRATEGY

Aled Jones (FTSE Russell) gave a presentation on sustainable investment and outlined the following key areas:

- FTSE Russell was an innovator in sustainable investment since 2001 and encouraged companies to increase their Environment, Social and Governance (ESG) exposure.
- Maintained two core data models: ESG ratings and Green Reserves.
- By splitting data into these two dimensions users could determine more specifically whether to target ESG issues related to (operational) risk or (product) opportunities.
- Provided an overview of the sustainable investment framework and summarised the FTSE all-world climate index performance.

The Chair asked if FTSE Russell were working with other Local Authorities. Aled Jones said that they had been working in collaboration with the HSBC Bank pension scheme since 2016, to generate a future world fund. Furthermore, they were in ongoing discussions with other Local Government Pension Scheme funds to develop and implement suitable strategies.

Michael Adam asked for further clarification on the difference between climate index and balance factors in relation to back tested performance. Aled Jones explained that the main difference for smart beta indexes was that it incorporated 4 different balanced factors. The approach was similar to combining the indexes with the market capitalisation starting point, however in addition included the derived factors. In relation to the back tested data, green revenue data was derived and put together by FTSE Russell, however a third-party organisation provided the emissions and reserves data.

Michael Adam asked if the factor exposure was consistent. In response Aled Jones said that the back-tested performance was based on the same methodology that was in effect when the index was officially launched. Furthermore, a dedicated research team was assigned to work on a methodology to derive the data and tilt methodology looked to give the greatest possible exposure to the factor of choice. Factors needed to be balanced more frequently to maintain a level of consistency. Furthermore, the factor weighting was determined during the methodology process and was not optimised when factors were rebalanced. He added that statistical data and performance charts including momentum would be provided to demonstrate that factor exposure was consistent.

Michael Adam said that it was important to focus on ESG approaches as well as Carbon footprint and asked if there were any opportunities of broadening the filters to expand this. Aled Jones explained that FTSE Russell had a range of different ESG indices outside of climate. Different options were being explored and they were also considering, combining the ESG and climate approach to offer additional alternatives. He explained that each fund was unique in its approach i.e. some funds were only concerned about climate change whilst some others chose a more broader approach.

The Chair asked about the cost implications to the Council if it opted for a more tailored approach. Jennie Barouxakis (FTSE Russell) explained that the standard cost was 2.5 basis points, however there would be additional implementation costs and would be happy to engage in further discussions around their pricing model.

The Chair thanked FTSE Russell for their presentation and their contributions made at the meeting.

Kevin Humpherson (Deloitte), outlined the key differences between the FTSE Russell and MSCI indexes. He explained that FTSE Russell approached the Council offering a comparable option to MSCI. In addition, FTSE Russell were overweight to companies with green revenues. Michael Adam said that although he was not against the proposals to divest against Carbon exposure, it was also vital for the Council to explore different hedging strategies. He felt that it was important for the Council to consider positioning its equities portfolio in a more defensive place in the short-term within a challenging market.

Kevin Humpherson (Deloitte), relating to page 109 of the agenda pack provided an overview of the Majedie vs Legal & General Investment Management (LGIM) benchmark analysis for carbon footprint. He explained that in comparison to LGIM, Majedie had a lower carbon footprint as a proportion of revenue generated, i.e. Majedie's portfolio was more carbon efficient. However, looking at carbon to value invested, which was a measure of the carbon footprint in a more absolute sense, LGIM had the smaller footprint.

The Chair asked what the outcome of the analysis meant for the future direction of travel for the Council's equity strategy. In response Kevin Humpherson explained that Majedie had a higher absolute carbon footprint, but its portfolio and the organisation in which it invested in was generating more revenue for every unit of carbon emissions when compared with LGIM. Furthermore, the LGIM low carbon fund in comparison with the current LGIM passive mandate, was significantly, less carbon-intensive across the board for both, less direct emissions, and indirect emissions. He said that immediate carbon divestment was not favourable at this stage and further analysis needed to be completed before a decision was made in relation to forming an equity strategy.

The Chair asked what other Local Authorities had chosen the MSCI low carbon index option and if there were any beneficial examples that could be brought to a future Sub-Committee for consideration. Kevin Humpherson said that the London Borough of Southwark had opted for the MSCI index.

Phil Triggs, Director of Treasury and Pensions explained that total divestment was rare and limited the Council's opportunities. In addition, the ability to directly engage with the company and its directors attracted most Local Government Pension Schemes. He highlighted that the Sub-Committee's key fiduciary responsibility was to manage the Fund's investments in the best interests of the beneficiary members and the Council tax payers, where the primary focus must be on generating an optimum risk adjusted return.

The chair said that he was keen to hear from LGIM and asked if they could be invited to a future meeting to explore further opportunities. Phil Triggs said that the Brunel pool could be considered as a useful example for the Council's wider strategy. He said that a paper of the strategies implemented by Brunel, as well as establishing the position of other LGPS funds would be brought to the next Sub-Committee. He said he would also invite a representative from Brunel to come and speak with the committee. In addition, Michael Adam asked for a paper to be brought on equity hedging and protection strategies.

Action: Phil Triggs

The Sub- Committee had decided to defer the decision of the transfer of choice of index to track in the global passive equity portfolio to the MSCI World Low Carbon Target Index. The aim was to explore further options and investment risks before a decision was reached.

RESOLVED

That the Sub-Committee approved the sale of the equity assets remaining in the residual Majedie Focus and Tortoise Funds and consolidation into the LGIM mandate.

7. EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED

That under Section 100A (4) of the Local Government Act 1972, that the public and press be excluded from the meeting during the consideration of the following items of business, on the grounds that they contain the likely disclosure of exempt information, as defined in paragraph 3 of Schedule 12A of the said Act, and that the public interest in maintaining the exemption currently outweighs the public interest in disclosing the information.

8. EXEMPT MINUTES OF THE PREVIOUS MEETING

RESOLVED

The exempt minutes of the meeting held on 23 July 2018 were approved and signed by the Chair.

9. CARBON EXPOSURE AND EQUITY STRATEGY - EXEMPT ELEMENTS

The exempt elements of the report were noted.

Meeting started: 7:00pm
Meeting ended: 8:50pm

Chair

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Pensions Sub-Committee Minutes

Tuesday 20 November 2018

PRESENT

Committee members: Councillors Iain Cassidy, Rebecca Harvey, Asif Siddique, and Matt Thorley

Co-opted members: Michael Adam

Officers: Phil Triggs (Director of Treasury & Pensions), Matthew Hopson (Strategic Investment Manager), Timothy Mpofu (Pension Fund Manager), Hitesh Jolapara (Strategic Director of Finance & Governance), Trevor Webster (Human Resources), Lesley Bell (Business & Performance Manager), and Amrita Gill (Committee Co-ordinator)

Guests: Kevin Humpherson (Deloitte) James Sparshott, Laura Brown, Graham Wardle (Legal & General) Faith Ward (Brunel Pension Partnership)

1. MINUTES OF THE PREVIOUS MEETING

RESOLVED

The minutes of the meeting held on 4 September 2018 were approved and signed by the Chair.

2. APOLOGIES FOR ABSENCE

There were no apologies for absence.

3. DECLARATIONS OF INTEREST

There were no declarations of interest.

4. EQUITY PROTECTION STRATEGY

Laura Brown, Legal & General - Investment Management (LGIM) provided a presentation and noted the following points:

- Outlined the reason LGPS clients were protecting their equity portfolios

- LGIM had a readymade pooled solution that was easy to implement subject to a reasonable fee
- As equity markets had risen, cost of protection had fallen
- Part of the strategy was to balance protection cost whilst retaining equity above 9% pa & minimising tracking error through aligning regional allocation to underlying equity benchmark
- Funds controlled their own equity protection and managed how this was allocated. Furthermore, Funds could also adjust their protection strategy as underlying equities changed. However, LGIM managed collateral requirements using the index equities holdings as well as protection contracts. In addition, index equities could be transformed into cash futures

Kevin Humpherson, Deloitte asked what were the key factors that contributed to driving the protection costs down. Laura Brown explained that interest rates had dropped, this therefore had an impact on costs.

Phil Triggs, Director of Treasury & Pensions asked for LGIM's views around the positioning of the current market. Graham Wardle, LGIM explained that that there needed to be sufficient return on the Fund's equities – markets were currently challenging, especially with the volatility surrounding the withdrawal of the UK from the European Union. Therefore, as a result it was difficult to diversify equities in this market.

Hitesh Jolapara, Strategic Director of Finance & Governance asked how many Public-Sector funds had opted for this strategy. In response Graham Wardle said that 6 LGPS funds had signed up for an equity protection strategy with LGIM over the last year.

Kevin Humpherson asked for clarification around the cost implications and management fees involved if the Council had decided to consider this option. Graham Wardle explained that the index equity would have the same fee as agreed with LCIV. This would include a standard cost of 4.5 basis points on the amount of equity available. In addition, there would be an implementation fee.

Phil Triggs, referring to page 11 of the agenda pack explained that officers had various discussions with advisors on whether adopting this strategy would be beneficial for the Fund, however concluded that it would not be advisable to implement any form of equity protection strategy at this time.

Michael Adam, Co-opted Member noted that in the first quarter markets had fallen at a similar time. He questioned whether it was appropriate not to form an equity protection strategy given that there was still some risk for markets to fall further. However, he noted that the advice recommended by advisors was also an essential element to be considered prior to making a decision. Kevin Humpherson explained that at this stage it was difficult to predict the future of equities due to the complex nature of the current market. Furthermore, the Council's Pension Fund had a low allocation to equities in comparison to the wider LGPS scheme, already having one of the lowest volatilities of the last ten years when compared to the LGPS universe.

The Chair explained that the Committee had noted the different types of equity protection strategies available to the Council and considered advice from professionals advising them of the potential solutions and whether they were appropriate for the Council's Pension Fund. However, the Sub-Committee unanimously agreed that adopting this strategy would not be beneficial for the Fund at this stage.

RESOLVED:

That the Sub-Committee noted the different types of equity strategies available and approved that the Pension Fund would not be pursuing any form of equity protection strategy at this time

5. CARBON EXPOSURE AND EQUITY STRATEGY

Faith Ward, Brunel Pension Partnership (BPP) gave a presentation highlighting BPP's approach to responsible investment and stewardship. She showed slides that outlined the different asset classes and reporting strategies. BPP had been running for two years and used environmental, social and governance (ESG) principles to help reduce risk - using an ethical and responsible investment approach whilst monitoring the financial implication for Funds. An update on the different group of Funds as well as the different investment principles was provided. There were 17 different sustainable development goals available to different Funds that contributed towards tangible progress.

Faith Ward explained that BBP was set up to implement an investment strategy of each Fund by exploring options for pooling investment assets. However, if any concerns were discovered, BBP would work in collaboration with the selected managers to resolve these issues. The objective of pooling assets was to achieve savings over the longer term from both lower investment management costs and more effective management of the investment assets. ESG was constantly moving directions due to a challenging market – managers needed to regularly review these issues and pressures to maintain the investment processes.

Councillor Matt Thorley thanked Faith Ward for her presentation and experiences shared on ESG integration. He noted that it was very informative and there was a lot of information delivered that needed to be considered. Furthermore, he asked why there was no mention of companies such as banks throughout the presentation. In response Faith Ward explained that the main area of focus for BPP was mobile ecosystems and Google rather than banks.

The Chair asked for details to be provided on the different Funds which contributed to ESG. Faith Ward, explained that there was a total of 10 pools that were managed by BPP and majority of them were heavily involved in the responsible investment strategy.

The Chair asked for clarification around how much work was being carried out individually by each Fund and the contributions made by BPP. In response Faith Ward explained that BPP supported the asset allocation strategy (developing their thinking). In addition, manager selection was also BPP's responsibility. Information was fed back to each Fund on a regular basis by providing quarterly reporting updates.

Phil Triggs, Director of Treasury & Pensions referring to page 19 of the agenda pack noted that the Fund's investment consultant had met with FTSE Russell and prepared a short paper (Appendix 1) on a comparison between the two managers. He explained that MSCI World Low Carbon was well established and the main provider to LGPS funds. It also had a preferential fee rate with the Fund's existing provider, Legal and General. The FTSE Russell World Low Carbon index took account of green revenues within such stocks as Royal Dutch, Shell, and BP.

Kevin Humpherson, Deloitte explained that given the lack of formal reporting requirements on carbon emissions, information gathered from FTSE was often inconsistent, incomplete, and lacking in quality. Therefore, their data collection process was very manual and data interpretation was time consuming. This was expected to change in the future as reporting requirements became more formalised. For these reasons as well as considering implementation, product availability and fees, he was of the view that MSCI Low Carbon Target Fund with LGIM was a more appropriate low carbon option for the Fund.

The Chair queried the timescales around the implementation to MSCI Low Carbon and the fees involved. Kevin Humpherson explained as the Fund's current passive equity allocation was with LGIM, moving to MSCI Low Carbon Fund would not involve any on-boarding documentation or set up work. There was a management fee of 2 basis points and the benefit of a preferential fee agreement with the London CIV.

Members felt that after taking into consideration all the reasons above, moving to MSCI Low Carbon would be the most appropriate option for the Council. They requested that the transfer took place when the overall asset allocation was considered.

The Chair thanked Faith Ward for the presentation and the contributions made to the meeting.

RESOLVED:

That the Sub-Committee approved the selection of the MSCI World Low Carbon Target Index.

6. CHANGES TO EMPLOYEE PENSIONS CONTRIBUTION BANDINGS CALCULATIONS

Matt Hopson, Strategic Investment Manager presented the report and explained that there would be some financial impact to the Pensions Fund,

arising from the move to the Hampshire County Council Integration Business Centre (IBC). He explained that there would be some changes to how employee contributions banding was calculated and the effect of auto-enrolment for some employees where opt out dates and forms were not held on Agresso. Members were automatically enrolled onto the Pension Scheme when employment commenced, however had the right to opt out of the scheme if they chose to, by signing an opt out form.

RESOLVED:

That the Sub-Committee noted the update

7. PIRC PERFORMANCE REPORT 2017/18

Matt Hopson, Strategic Investment Manager provided an overview on the investment performance of the Fund during the financial year 2017/18. He explained that the average local authority Fund produced a return of 4.5%. In comparison the Council's Pension Fund produced 1.7% which was below average and ranked in the 95th percentile. The reason for the lower return was due, in part to the Fund's lower equity exposure and much higher bond allocation when compared to the structure of the average LGPS fund. However, the Council's Fund had managed to deliver a much higher long-term return than average at a relatively low level of volatility. This was the optimal combination which would suggest strong Fund stewardship over the long term.

Furthermore, the average LGPS fund delivered an annualised performance of 9% per annum driven largely by strong long-term equity performance. Bonds had also performed well over the longer term assisted by 'quantitative easing'.

RESOLVED:

That the Sub-Committee noted the update.

8. PENSION FUND QUARTERLY UPDATE PACK

Kevin Humpherson Deloitte, presented the report for the quarter ending 30 September 2018.

Michael Adam, Co-opted Member questioned why had there been a disappointing performance delivered by the Insight fund. Kevin Humpherson said that this was predominately due to timing and the Fund had underperformed solely due to the challenging market conditions. There were no issues in relation to the management of the Fund. Deloitte were in the process of conducting a review of the product. Furthermore, a broader review of all Funds would be conducted and a report would be brought to a future Sub-Committee meeting.

Action: Kevin Humpherson

Matt Hopson explained that the Pensions Fund risk register (Appendix 4) had been revamped to show a more meaningful assessment of risks and the actions taken to mitigate them. This had led to the identification of additional

risks in investment governance and administrative areas. Mat Hopson in response to a question, confirmed that the UK's departure of the European Union had been included as a risk (Risk 8).

The Chair requested that the Audit Committee and climate risk to be added to the risk register.

Michael Adam referring to page 82 of the agenda pack, requested that a summary of the annual net flow deficit to be included in the cashflow breakdown and brought to the next Sub-Committee meeting.

Action: Matt Hopson

RESOLVED:

That the Sub-Committee noted the update.

9. GOVERNMENT ACTUARIES DEPARTMENT (GAD) REPORT

Phil Triggs, Director of Treasury & Pensions introduced the item and noted that the report and appendices provided an update on the GAD report on the 2016 LGPS triennial actuarial valuation outcome.

Hitesh Jolapara, Strategic Director of Finance & Governance explained that the original report was uncomplimentary of the LGPS and not reflective of the majority of Funds being in a strong position. Some of the tests were regarded by LGPS actuaries as being not fit for purpose. Upon receiving notable challenges from various actuarial firms, GAD revised their report reflecting the improving funding positions across the board. The Council received green flags across the board on the GAD's various tests. This reflects the Fund was in a relatively strong position.

RESOLVED:

That the Sub-Committee noted the update

10. LGPS ADMINISTRATION PERFORMANCE UPDATE REPORT

Trevor Webster, Human Resources explained that the day to day administration of the Council's LGPS was delegated to Surrey County Council (SCC) under a section 1010 agreement effective from 1 September 2015.

In 2016 it was agreed that SCC would focus on resources on the resolution of queries at the first point of contact via a dedicated help desk to enhance the user experience. As a result, the rate of first point of contact resolution based on an average of 500 queries per month had increased to 93%.

Councillor Rebecca Harvey asked what was the reason for the number of Transfers in and out to be considerably lower than the rest of the data. Trevor Webster explained that the performance was recognised as unacceptable. A lot of time was spent cleansing and rectifying the data inherited from Capita which had resulted in a back log that needed to be reviewed. However, SCC were creating a specialist team to deal with Transfers. Transfers were

recognised as being complex calculations that included receiving information from other organisations and therefore required a dedicated resource. The Council expected that this change would result in KPI 'transfers' being met going forward.

Trevor Webster noted that KPI information would be provided by SCC monthly from December 2018 rather than quarterly, so that performance could be tracked in a timely way. There had also been some service improvements which focused on enhancing the scheme members and employer experience, two new portals had been launched.

In Q2 SCC had conducted a day of 1-2-1 sessions for staff who self-nominated and there were plans to launch group engagement events linked to the wider HR strategy early in 2019.

The Chair asked if plans to create a national dashboard to enable people to view and track their pensions via the national portal were still in place. Phil Triggs explained that the LGPS data would feed into the new national system, however timescales around this were still to be confirmed.

RESOLVED:

That the Sub-Committee noted the update

11. AMENDMENTS TO THE PENSION BOARD TERMS OF REFERENCE

Trevor Webster, Human Resources explained that the levels of expertise and continuity required from all members of the Pension Board had resulted in the original requirement for representatives to serve a fixed term of the office of just two years had proven impractical. It was therefore recommended that the term of office should be increased to four years. In addition, there was no conflict with the Public Services Pensions Action 2013 regarding this proposal.

Michael Adam, Co-opted Member highlighted that it would be good practice to invite a trade union representative to attend future Pensions- Sub Committee meetings.

Action: Amrita Gill


RESOLVED:

That the Sub-Committee approved an amendment to the Pension Board Terms of Reference to increase the Employer and Employee representatives fixed term of office from two years to four years. The Employers representative with a start date of May 2018 to synchronise with the Councils election cycle and the Employees representatives to have a start date of July 2015

Meeting started: 7:00pm
Meeting ended: 9:50pm

Chair

Contact officer: Amrita Gill
Committee Co-ordinator
Governance and Scrutiny
☎: 020 8753 2094
E-mail: amrita.gill@lbhf.gov.uk

<p>London Borough of Hammersmith & Fulham</p> <p>PENSIONS BOARD</p> <p>6 February 2019</p>		
<p>LOCAL GOVERNMENT PENSION SCHEME (LGPS) ADMINISTRATION PERFORMANCE UPDATE REPORT.</p>		
<p>Report of the Mark Grimley – Director of Corporate Services</p>		
<p>Open Report</p>		
<p>Classification: For Information Key Decision: No</p>		
<p>Consultation: N/A</p>		
<p>Wards Affected: N/A</p>		
<p>Accountable Director: Mark Grimley – Director of Corporate Services</p>		
<p>Report Author: Trevor Webster Bi-Borough Pensions</p>		<p>Contact Details: Tel: 0771 5771496 E-mail: trevor.webster@rbkc.gov.uk</p>

1. EXECUTIVE SUMMARY

- 1.1. The day to day administration of the LBHF LGPS is delegated to Surrey County Council (SCC) under a Section 101 agreement effective from 1 September 2015.
- 1.2. The Section 101 agreement includes Key Performance Indicators (KPIs) which are generally consistent with national standards, are monitored by the Bi-Borough Pensions and LBHF Human Resources teams.
- 1.3. In addition to the transactional administration service delivered by SCC there are also agreed service improvements in progress, an employee engagement plan and data cleansing deliverables agreed between LBHF and SCC.
- 1.4. This report provides an update of performance against the agreed KPIs, shows the priorities within service improvement plan, updates the employee engagement plan and highlights the data cleansing deliverables.

2. RECOMMENDATIONS

- 2.1 That the Pensions Board notes the contents of this report.

3. SURREY COUNTY COUNCIL'S PERFORMANCE AGAINST THE KPIS

- 3.1. SCC's performance against the agreed KPIS is shown in Appendix 1 covering Q2 of the financial year 2018/19, the average performance for the years 2016/17 and 2017/18, and the very most up to date information covering the month of December 2018.
- 3.2. In 2016 it was agreed between LBHF and SCC that SCC should focus resources on the resolution of queries at the first point of contact via a dedicated help desk to enhance the user experience.
- 3.3. As a result, the current rate of first point of contact resolution based on an average of 500 queries per month is 89%
- 3.4. In 2017/18 the first point of contact rate was 87% and in 2015/16 it was 81%.
- 3.5. Following the Q2 KPIS results being received October 2018 it was recognised that Transfer In and Transfer Out performance was unacceptable. Transfers are complex calculations that need the active support of other employers.
- 3.6. In response SCC created a specialist team to deal with all Transfers and performance in this area has now significantly improved.
- 3.7. It has also been agreed that KPI information will be provided by SCC monthly from December 2018 rather than quarterly, so that performance can be tracked in a timelier fashion.

4. UPDATE ON THE SERVICE IMPROVEMENTS IN PROGRESS

- 4.1. In addition to the delivery of the transactional pensions service detailed in the Section 101 agreement, SCC and LBHF have agreed service improvements focussed on enhancing the Scheme Member and Employer experience.
- 4.2. To support the generic pensions website, in Q2 two new portals were launched. These portals are designed for use by Scheme Members and Employers with the aim of providing better more up to date paperless information.
- 4.3. For the first time the Annual Benefit Statements (ABSs) for the year 2017/18 were made available online via the portal to Scheme Members. Automatic paper copies of ABSs were simultaneously withdrawn with the subsequent reduction in printing and postage costs realised.

- 4.4. The functionality of the Scheme Member Portal also allows for members to view their own personal pensions records and to calculate estimated projected pensions benefits.
- 4.5. The Employers Portal has been developed with the intention of allowing Admitted Body and Scheduled Body Employers to submit notifications and returns on line in the future.
- 4.6. In order to realise the full benefits from the Employers Portal, LBHF recognises that further engagement with third party employers will be required as part of the service development plans for the next year.

5. STAFF ENGAGEMENT

- 5.1. During Q2 LBHF employees were offered 1-2-1 sessions with SCC Pensions Advisors. Over 40 employees were given slots and positive feedback was received. The sessions were oversubscribed so there are developing plans to hold lunch and learn engagement events for a wider number of people in the future linked to the wider HR strategy.

6. TRIENNIAL VALUATION 2019

- 6.1. The data for the next triennial valuation will be cut from SCC's Pension Administration System (Altair) as at the 1st April 2019.
- 6.2. The data is sent by SCC to the Pension Fund Actuary (Barnett Waddingham), whose role is to perform a valuation of the whole Pension fund income against its current and projected liabilities, using a series of sophisticated industry recognised algorithms.
- 6.3. The output from this exercise is an actuarially assessed LGPS employer rate for each employer for the next three years starting from 1st April 2020, which may in some rare cases include an additional lump sum to cover historic liabilities.
- 6.4. In conjunction with the Pensions Actuary, SCC are currently carrying out a data error identification exercise to ascertain what historical data inaccuracies and inconsistencies inherited from Capita must be addressed prior to the start of the data extract this is to ensure that the Employers' rates are calculated accurately. This work has started and is ongoing.

7. EQUALITY IMPLICATIONS

- 7.1. None

8. LEGAL IMPLICATIONS

- 8.1. None

9. FINANCIAL IMPLICATIONS

9.1. None

10. IMPLICATIONS FOR LOCAL BUSINESS

10.1. None

11. COMMERCIAL IMPLICATIONS

11.1 None

12. IT IMPLICATIONS

12.1. None

13. RISK MANAGEMENT

13.1 N/A

14. BACKGROUND PAPERS USED IN PREPARING THIS REPORT

14.1 None

LIST OF APPENDICES:

Appendix 1 KPI Report – Hammersmith & Fulham Fund


KPI Report – Hammersmith & Fulham Fund

Description	Target as per Section 101 agreement (working days)	Target	2016/17	2017/18	2018/19 Q2	December 2018	Comments
Monthly Pensioner Payroll							
Full reconciliation of payroll and ledger report provided to Borough	Last day of month	100%	100%	100%	100%	100%	
Issue of monthly payslips	3 days before pay day	100%	100%	100%	100%	100%	
RTI file submitted to HMRC	3 days before pay day	100%	100%	100%	100%	100%	
BACS File submitted for payment	3 days before pay day	100%	100%	100%	100%	100%	
Annual Exercises							
Annual Benefit Statements Issued to active and deferred members	31 August		September	On line	On line	N/A	
P60s Issued to Pensioners	31 May		Achieved	Achieved	100%	N/A	
Apply Pensions Increase to Pensioners	April		Achieved	Achieved	100%	N/A	
Pensioners Newsletter	April		Achieved	Achieved	Achieved	N/A	
Pension Administration							
Help desk (resolution of queries at the first point of contact) – 500 cases per month	N/A	N/A	81%	87%	93%	89%	
Death Benefits Write to dependant and provide relevant claim form	5 days	100%	80%	N/A	100%	100%	

Description	Target as per Section 101 agreement (working days)	Target	2016/17	2017/18	2018/19 Q2	December 2018	Comments
Set up any dependant's benefits and confirm payments due	10 days	100%	93%	N/A	94%	67%	
Retirements New retirement benefits processed for payment following receipt of claim forms	7 days	100%	71%	94%	89%	100%	
Deferred retirement benefits processed for payment following receipt of claim forms	7 days	100%	78%	70%	95%	80%	
Refunds of Contributions Refund paid following receipt of claim form	10 days	100%	98%	100%	42%	100%	
Deferred Benefits Statements sent to member following receipt of leaver notification	20 days	100%	65%	63%	58%	85%	Includes inherited historical Capita backlog
Estimates Early Retirement requests from employer privileges	10 days	100%	70%	89%	90%	100%	
Projections Requests from employees	10 days	100%	51%	50%	89%	100%	

Description	Target as per Section 101 agreement (working days)	Target	2016/17	2017/18	2018/19 Q2	December 2018	Comments
New Joiners New starters processed	30 days	100%	94%	100%	100%	N/A	
Transfers In Quote estimate to scheme member (includes inter-funds)	20 days	100%	80%	50%	36%	100%	
Transfers-in payments processed	20 days	100%	89%	100%	100%	83%	
Transfers Out transfers-out quotations processed (includes inter-funds)	20 days	100%	77%	86%	71%	100%	
Transfers out payments processed	20 days	100%	92%	100%	100%	N/A	

Agenda Item 7

<p>London Borough of Hammersmith & Fulham</p> <p>PENSIONS BOARD</p> <p>6 February 2019</p>		
<p>NON-PAYMENT OF PENSIONS CONTRIBUTIONS BY TBAP MULTI ACADEMY TRUST (THE BRIDGE AP ACADEMY)</p>		
<p>Report of the Mark Grimley – Director of Corporate Services</p>		
<p>Open Report</p>		
<p>Classification - For information</p>		
<p>Key Decision: No</p>		
<p>Consultation N/A.</p>		
<p>Wards Affected: All</p>		
<p>Accountable Director: Mark Grimley – Director of Corporate Services</p>		
<p>Report Author: Trevor Webster Bi-Borough Human Resources Pensions</p>		<p>Contact Details: Tel: 0771 5771496 E-mail: trevor.webster@rbkc.gov.uk</p>

1. EXECUTIVE SUMMARY

- 1.1 The TBAP Multi-Academy Trust was established in March 2013 and is an approved DfE Academy Sponsor. The TBAP Executive Board maintains strategic and statutory responsibility for TBAP AP Academies and services including the Bridge AP Academy.
- 1.2 The Bridge AP Academy is a LBHF secondary alternative provision (AP) academy that provides full-time education and support for up to 150 learners who are not accessing mainstream schools.
- 1.3 Accordingly, TBAP are a scheduled body of the LBHF Local Government Pensions Fund.
- 1.4 As detailed in the LBHF Pensions Administration Strategy TBAP have the responsibility to deduct monthly all pension contributions from a member's pay, including Additional Pension Contributions (APCs) and Additional Voluntary Contributions (AVCs) as may be required, and to pay over all

pension contributions within the statutory deadlines in accordance with the requirements of the Administering Authority.

- 1.5 Between July 2017 and March 2018 due to cash flow issues TBAP failed to pay over the employer and employee contributions to the fund in respect of The Bridge AP Academy employees who are members of the Local Government Pension Scheme (LGPS).
- 1.6 The Bi-Borough Retained Pensions Team conducted a series of telephone and written conversations with TBAP until the matter was resolved.
- 1.7 Notwithstanding that all contributions are now up to date (including all back contributions), the Administering Authority fulfilled its responsibility by reporting the issue to the Pensions Regulator.
- 1.8 This matter is now considered closed by the Pensions Regulator and their reply is attached in Appendix 1.
- 1.9 Due to the seriousness of this matter it is appropriate to notify the Pensions Board of this issue.

2. RECOMMENDATIONS

- 2.1 That this report be noted

3. ACTIONS TAKEN BY THE ADMINISTERING AUTHORITY

- 3.1 In late 2017, through the Bi-Borough Pensions Team, the Administering Authority appointed a dedicated resource to monitor contributions from Scheduled and Admitted Bodies.
- 3.2 As a result of the appointment of this resource the missing contributions from TBAP was monitored and discovered and contact made with TBAP that resulted in the contributions being brought up to date.
- 3.3 A weekly monitoring tracker of Scheduled and Admitted body contributions is continuing to be produced and appropriate action taken when contributions are not received on time.
- 3.4 The LBHF Pensions Administration Strategy will be reviewed in 2018/19 and resent to all Scheduled and Admitted bodies to remind them of their responsibilities.
- 3.5 The Bi-borough Retained Pensions team are in discussion with the LBHF Pensions Administrators Surrey County Council regarding the introduction of a new software system that will reconcile contributions monthly to the member's record. The introduction of this new system will further enhance management control over the process. It is envisaged that this will be introduced to all

Scheduled and Admitted Bodies through a rolling programme during the financial year 2018/19.

4. EQUALITY IMPLICATIONS

4.1 None

5. LEGAL IMPLICATIONS

5.1 None

6. FINANCIAL IMPLICATIONS

6.1 None

7. IMPLICATIONS FOR LOCAL BUSINESS

7.1 None

8. COMMERCIAL IMPLICATIONS

8.1 None

9. IT IMPLICATIONS

9.1 None

10. RISK MANAGEMENT

10.1 N/A

11. BACKGROUND PAPERS USED IN PREPARING THIS REPORT

11.1 None

LIST OF APPENDICES:

Appendix 1: Letter from the Pensions Regulator dated 12th November 2018

The Pensions Regulator

Napier House
Trafalgar Place
Brighton
BN1 4DW

T 01273 648451
E Hale.Ucar@tpr.gov.uk

www.thepensionsregulator.gov.uk
www.trusteetoolkit.com

Private and Confidential

The Scheme Manager
Local Government Pension Scheme
London Borough of Hammersmith & Fulham PF
FAO Maria Bailey
Town Hall
Hornton Street
London
W8 7NX

Sent by SecureMAIL to: Maria.Bailey@rbkc.gov.uk

12 November 2018

Our reference: **PSR 10272022**, C117382271

Dear Ms Bailey,

Breach of Law (BoL) report in relation to TBAP Multi Academy Trust (The Bridge AP Academy) (the Employer)

Thank you for your time and assistance in responding to our questions on the conference-call we held on 17 September 2018. I have met with my case team since then and we have considered the information you have provided. This letter sets out our key findings and conclusions on this case.

Reporting breaches of the law

We have noted from the BoL report, which David Coats submitted to us in May 2018, that TBAP, the Employer, failed to pay employer and employee contributions into the London Borough of Hammersmith & Fulham Pension Fund (the Scheme). We understand that these breaches were in respect of contributions for the period of July 2017 through to March or April 2018 (with the exception of the contributions due for September 2017, which were paid). During our conference-call, you explained that you were aware of the non-payments since August 2017 when the July 2017 payment was due. Whilst we understand that you interacted with the Employer from that time while the Employer sought to establish whether the contributions had been overpaid in the past and the contribution amounts which were due going forward, which was finally confirmed in March 2018, it was only when the Employer stated in May 2018 that they were unable to make the outstanding payments due to their 'cash-flow issues' that the breach was reported to The Pensions Regulator (TPR).

As discussed during our call, this is a very significant period of time for breaches of this kind to have persisted and to have been reported as late as they were. In particular, we regard any failure to pay to the Scheme contributions which have been deducted from employees' pay as

an extremely serious matter, irrespective of cause. Regardless of the efforts made by the Scheme Manager to understand the cause of the breaches and pursue rectification, it is the Scheme Manager's legal obligation to make TPR aware of breaches which are likely to be of material significance to us within the legislative timeframe.

The Scheme Manager must report payment failures which are likely to be of material significance to the regulator within a reasonable period, in the case of employee contributions, and as soon as reasonably practicable, in the case of employer contributions. The Code sets out TPR's view on what constitutes a 'reasonable period' and 'as soon as reasonably practicable'. The Code also gives examples of when a breach would be of material significance to TPR. These examples include any payment which has been outstanding for more than 90 days from the due date.

A penalty may be applied to any Scheme Manager who has failed to take all reasonable steps to comply with their duty to report late payment of employee contributions. A penalty may also be applied to any Scheme Manager who has failed without reasonable excuse to comply with their duty to report late payment of employer contributions.

These duties and accompanying practical guidance are clearly set out in our Code of practice 14, in the section 'Maintaining contributions' (paragraphs 147 – 186 of the Code), specifically under the sub-heading of 'Reporting payment failures which are likely to be of material significance to the regulator' in paragraphs 173 – 186.

www.thepensionsregulator.gov.uk/codes/code-governance-administration-public-service-pension-schemes.aspx#s16855

Please also see the relevant sections here:

www.thepensionsregulator.gov.uk/public-service-schemes/reporting-breaches-of-the-law.aspx#s15892

www.thepensionsregulator.gov.uk/public-service-schemes/maintaining-contributions.aspx

Internal controls

The Scheme Manager is required to establish and operate internal controls - systems, arrangements and procedures - in order to run the scheme in accordance with the scheme rules and legislation. One of the critical elements of internal controls is effective risk management whereby risks are detected in a timely manner and actively managed by the scheme manager.

In line with my comments under the first section above, even though the Scheme Manager was aware of the issue from an early stage, effective internal controls, including risk management practices, do not seem to have been operated. The Scheme Manager should have had adequate mechanisms in place to regularly monitor contributions from employers and be able to verify the contribution rates and calculation of contributions. This in turn would enable the Scheme Manager to robustly challenge employers who alleged there had been overpayments of contributions. Robust challenge to the Employer at an early stage may have achieved a quicker resolution. The Scheme Manager should also have taken steps to ensure that contributions continued to be paid to the Scheme while any necessary reconciliations were carried out, thus protecting members and scheme assets.

TPR can take action where a scheme manager has failed to establish and operate adequate internal controls. Such action could include issuing an improvement notice or appointing a skilled person to provide us with a report.

Based on the conversation we held, we understand that a close monitoring mechanism with allocated resource has now been put in place which you assured us is appropriate to address

any future similar risks. You may also wish to consider preparing a pension administration strategy under the LGPS Regulations 2013 (to the extent this has not already been done), setting out the Scheme Manager's policies in relation to various matters including the circumstances in which the Scheme Manager may consider giving written notice to any of its Scheme employers on account of that employer's unsatisfactory performance in carrying out its Scheme functions.

Please refer to the relevant sections of the Code 14 in the links below:

www.thepensionsregulator.gov.uk/public-service-schemes/internal-controls-and-managing-risks.aspx

Sections in particular 147 – 172 in www.thepensionsregulator.gov.uk/codes/code-governance-administration-public-service-pension-schemes.aspx#s16851

www.thepensionsregulator.gov.uk/docs/PS-reporting-breaches-examples-traffic-light-framework.pdf

www.thepensionsregulator.gov.uk/docs/public-service-internal-controls-checklist.pdf

Communication with the members

We are also disappointed that the members affected were not informed of the breach. The Scheme Manager is required to notify members of an employer's failure to pay to the Scheme contributions deducted from their pay where the Scheme Manager has reasonable cause to believe that the failure is likely to be of material significance to TPR. We note your view that this is a sensitive area and any such communication would have caused concern among members and potentially other parties, such as parents of pupils attending the academy. However, the legislation is in place to protect members and it was their legal right to be informed of the situation.

A penalty may be applied to any scheme manager who has failed to take all reasonable steps to comply with this duty.

Going forward, we expect the Scheme Manager to meet their legal duties, and follow the code and guidance provided on our website in so doing:

www.thepensionsregulator.gov.uk/public-service-schemes/communicating-to-members.aspx

www.thepensionsregulator.gov.uk/docs/code-14-public-service.pdf (in particular paragraphs 149 and 184)

Pension board knowledge and understanding

In this case, we are not aware of the extent to which the pension board was involved in the matter or whether it assisted the Scheme Manager in the handling of the breaches.

Pension board members must have knowledge and understanding of the scheme rules, documented scheme administration policies and the law relating to pensions, sufficient for them to exercise the functions of their role. They should be able to identify and, where relevant, challenge any failure to comply with the scheme regulations and other legislation relating to governance and administration as well as any failure to meet the standards and expectations set out in any relevant codes of practice issued by TPR.

We expect the Scheme Manager to share the contents of this letter with the pension board members and remind them of our expectations of them. The relevant section of the code and guidance can be found on our website:
www.thepensionsregulator.gov.uk/public-service-schemes/knowledge-and-understanding-duty-on-board-members.aspx

Conclusion

Despite our disappointment with the Scheme Manager's failings, including the delay in reporting the breaches, and in the case of members' communication, the lack of any action, we are pleased that the contributions were eventually paid in full by the Employer. We also note your reassurance that you have put appropriate mechanisms in place since May 2018 to monitor contributions being paid into the Scheme on a monthly basis.

Given the points we have raised above, we would expect all persons acting on behalf of the Scheme Manager to enhance their knowledge and understanding of the Scheme Manager's legal duties in running a Public Service Pension Scheme. This can be done through the PSPS section of TPR's online training platform 'Trustee Toolkit'
www.thepensionsregulator.gov.uk/public-service-schemes/learn-about-managing-public-service-schemes.aspx and/or any suitable external training. A wealth of information is also available on our website, such as the public service code of practice and accompanying guidance.

Based on the information supplied, the Regulator does not intend to take any further action in relation to the late payment of employee or employer contributions.

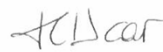
Please be aware that, should additional information be reported, we do reserve the right to reconsider this decision.

Please note that we are also writing to the employer organisation, TBAP, reminding them of their duties as a participating employer in several local government pension funds.


You should share and discuss the content of this letter with all relevant parties such as all who act on behalf of the Scheme Manager and the members of the Pension Board; please also consider sharing it with the Scheme's advisors where appropriate.

For more information on our risk-based approach please see our website at
www.thepensionsregulator.gov.uk

Yours sincerely



Halé Ucar
Case Manager
Frontline Regulation Directorate

<p>London Borough of Hammersmith & Fulham</p> <p>PENSIONS BOARD</p> <p>6 February 2019</p>	
EQUITY PROTECTION STRATEGY	
Report of the Strategic Director, Finance and Governance	
Open Report	
Classification - For Information	
Key Decision: No	
Wards Affected: None	
Accountable Director: Philip Triggs, Tri-Borough Director of Pensions and Treasury	
Report Author: Matt Hopson, Strategic Investment Manager	Contact Details: Tel: 0207 641 4126 E-mail: mhopson@westminster.gov.uk

1. EXECUTIVE SUMMARY

1.1 This paper provides the Pensions Board Members a summary of:

- a. The different types of equity protection.
- b. The likely characteristics of these different options.
- c. Potential solutions and whether they are appropriate for the Hammersmith and Fulham Pension Fund.

2. RECOMMENDATIONS

2.1 The Board is requested to note:

- a. The different types of equity protection strategies available.
- b. The Pension Fund Sub-Committee's decision to not pursue any form of equity protection at this time.

3 EQUITY PROTECTION BACKGROUND AND STRATEGIES

- 3.1 As at 30 September 2018, the Fund had an allocation to equities of 48%, split between a passive equity investment for LGIM (32%) and an active UK equity strategy with Majedie, (16%) split across three Majedie strategies (Global, Tortoise and Focus). Since the sale of the Fund's Tortoise and Focus funds with Majedie, this is now 33% and 14% respectively as at 4 November 2018.
- 3.2 With equity valuations now close to all-time highs, it should be considered whether the Fund is carrying a significant amount of risk in this area.
- 3.3 At the Pensions Sub-Committee meeting held on 4 September 2018, this was discussed further and, subsequently, a special training session was held on the subject to ensure the Pensions Sub-Committee was fully briefed on all areas of equity protection.
- 3.4 The Fund's investment consultant, Deloitte, hosted this training on 20 November 2018.
- 3.5 The Sub-Committee was informed that several Local Government Pension Schemes, including Surrey County Council and LB Islington Pension Funds, had implemented equity protection strategies over the last year.
- 3.6 Appendix 1 to this report sets out in detail the different types of strategies available that provide equity downside protection. However, the key areas of consideration are whether they are pooled or segregated mandates, and whether they provide downside protection at cost or provide this protection whilst foregoing a degree of upside at nil cost.
- 3.7 Pooled solutions are often overlaid by the incumbent manager of the portfolio, who will manage the associated derivatives strategy. Segregated solutions require the Fund to own and manage these derivatives. This is not desirable due to the complexity and potential risk that this brings, so a pooled approach would be the preferred solution.
- 3.8 Often the Fund can achieve protection on the downside by relinquishing a specified proportion of the upside. A possible scenario is that the Fund could forgo any gain above 7% on the portfolio but will be protected on any losses from -5% downwards towards a maximum loss of -30%.
- 3.9 It should be noted that this strategy is proven to be sub-optimal in the long term due to the large amounts of upside lost but is useful for managing downside risk over a shorter period of time, such as a year before the conclusion of the triennial cycle or maybe the entirety of a triennial cycle.
- 3.10 The other option is to purchase protection for a certain amount of downside. This would remove the upside loss, but it can be prohibitively expensive to implement depending on the desired level of protection and the chosen duration.

- 3.11 One of the most effective ways to manage equity downside is to vacate the asset category, selling equities and moving into an alternative, non-correlating, and perhaps less risky asset class.

4 EQUITY PROTECTION APPROACH

- 4.1 Given the complexities around using derivatives on active portfolios as discussed in the appendix, the Sub-Committee was advised against implementing such a strategy on the Majedie portfolio.
- 4.2 However, the Sub-Committee did discuss whether it should implement an equity protection strategy overlay on the largest of the Fund's equity portfolios, the passive holdings with LGIM. The main considerations were:
- The Fund could still protect around a third of its equity holdings without giving up too much upside. This would result in a hedge without making a bet on the market.
 - LGIM had a ready-made pooled solution which would have been easy to implement subject to a reasonable fee.
 - The solution could be implemented for a specified timescale that in line with the Fund's objectives.
- 4.3 It should be noted that as pricing moves for derivatives, the price on a nil cost basis to implement would not always be a viable option for the Fund. If the equity upside forgone is too much, it would be contrary to the assumed actuarial rate of return (decided at the 2016 actuarial valuation) and impact the discount rate of the liabilities.
- 4.4 Officers have had numerous discussions with advisors on whether adopting this strategy would be beneficial for the Fund, but concluded that it would not be beneficial for the following reasons:
- The Hammersmith and Fulham Pension Fund has a low allocation to equities in comparison to the Local Government Pension Scheme as a whole, and already having one of the lowest volatilities of the last ten years when compared with the LGPS universe.
 - The diversification of the Fund into long lease property and infrastructure allocations provides less correlated returns to equity markets for the Fund.
 - The allocation to Ruffer which, typically, will outperform during times of equity downturn with exposure to index-linked gilts and precious metal allocations, will provide a degree of insurance against an equity fall.
 - The Fund still requires growth assets as it is not yet fully funded.
 - There had already been a market correction of around 6% to 7% for the Dow Jones industrial and S&P500 indices from their recent October 2018 highs.
 - There are significant costs of implementation for the protection strategies of around 40 basis points, so even the nil cost option would not be implemented at nil cost.

- 4.5 It is for the reasons above that the officers recommended for the Pensions Sub-Committee not to pursue this option further at the November meeting. The Sub-Committee agreed to not implement the option for the foreseeable future.

5 CONSULTATION

- 5.1 Not Applicable

6 EQUALITY IMPLICATIONS

- 6.1 Not applicable

7 LEGAL IMPLICATIONS

- 7.1 None

8 FINANCE AND RESOURCES IMPLICATIONS

- 8.1 Finance risks are outlined within the report.

9 IMPLICATIONS FOR BUSINESS

- 9.1 Not applicable

10 RISK MANAGEMENT

- 10.1 Risks are outlined within the report.

11 PROCUREMENT IMPLICATIONS

- 11.1 None

12 IT STRATEGY IMPLICATIONS

- 12.1 None

LIST OF BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
1.	None		

LIST OF APPENDICES:

Appendix 1: Equity Protection Strategies

London Borough of Hammersmith & Fulham Pension Fund Equity Protection Strategies

Introduction

This report has been prepared for the Pensions Sub-Committee ("the Sub-Committee") of the London Borough of Hammersmith & Fulham Pension Fund ("the Fund"). The purpose of this report is to provide a summary of equity protection fund structures including the advantages and disadvantages associated with different structures and the factors to consider when appointing an investment manager.

Equity Protection Fund Structures

The table below shows the advantages and disadvantages of a segregated and pooled approach.

	Pros	Cons
Segregated	Greater portability and transparency	Underlying derivatives in name of scheme
	More flexibility over levels of leverage	More onerous documentation requirements
		Potential open-ended liability depending on nature of derivatives used
		More time consuming to implement for LGPS
		Not all managers able/willing to provide pooled fund wrapper
Pooled	Access to manager's derivatives documentation	Admin charge for providing pooled fund structure
	Reporting provided by manager and can appear as single line in report & accounts	Limitations on leverage levels within certain fund structures (CSUF cannot have leverage, can have leverage in QAIF)
	Liability limited	
	Reporting easier	

Factors to Consider

Degree of precision

- Protecting all market exposures or focusing purely on major markets.
- Option to use local market index contracts where there exists potential mismatch between derivatives contracts and underlying equity exposure, however there is greater liquidity in the major markets – UK, US, Europe etc.
- An alternative is to use MSCI Index series – however these derivative contracts are dollar denominated and the currency issue is not straightforward to resolve. An advantage of MSCI is that the index series is total return while local market indices are usually just price. Local market index contracts will be in the local market currency – Eurostoxx is priced in euros.

Time horizon

- How long do you want the protection to run? If looking to protect up to next valuation, it is logical to protect up to the expected time of signing off the valuation report.
- Possible to buy protection 2 – 3 years out, but pricing/liquidity is thinner for longer dated structures.

What protection needed on the downside?

- Market pricing “thin” if looking for protection below -30%.
- The norm appears to be to accept small downside (-5%), with protection then down to somewhere in the region of -25% to -30%.
- Interesting to look at long run historic returns over rolling 1, 2 and 3 year periods.

Impact on expected return

- If implementing rolling programme of protection where selling away upside to fund the downside, this will impact level of expected return in actuarial assumptions.
- Need to take into account what returns are likely on the upside – no point in implementing if the maximum return possible on upside isn't in line with assumptions used in valuation.

Cashflows

- Is the equity allocation likely to reduce over the term of the protection to meet pension payments?
- While structure can be altered, there will be costs associated with any restructuring.

Collateral

- What assets will be used for collateral?
- Option to sell equities and replace exposure with futures to release cash, or use gilts & cash.

Alternatives to equity protection strategy

- Given gains of equities in recent years, can you afford to reduce the equity exposure rather than implement a complex structure?

Conclusion

This paper should be considered in conjunction with discussions on equity protection strategies at the Committee meeting taking place on 20th November 2018.

The Sub-Committee may wish to consider whether they want to move forward with equity protection strategies following better understanding of this area and implementation options available.

Deloitte Total Reward and Benefits Limited

November 2018

Risk Warnings

- Past performance is not necessarily a guide to the future.
- The value of investments may fall as well as rise and you may not get back the amount invested.
- Income from investments may fluctuate in value.
- Where charges are deducted from capital, the capital may be eroded or future growth constrained.
- Investors should be aware that changing investment strategy will incur some costs.
- Any recommendation in this report should not be viewed as a guarantee regarding the future performance of the products or strategy.

Our advice will be specific to your current circumstances and intentions and therefore will not be suitable for use at any other time, in different circumstances or to achieve other aims or for the use of others. Accordingly, you should only use the advice for the intended purpose.



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<p>London Borough of Hammersmith & Fulham</p> <p>PENSIONS BOARD</p> <p>6 February 2019</p>	
<p>CARBON EXPOSURE AND EQUITY STRATEGY</p>	
<p>Report of the Strategic Director, Finance & Governance</p>	
<p>Open Report</p>	
<p>Classification - For Information</p>	
<p>Key Decision: No</p>	
<p>Wards Affected: None</p>	
<p>Accountable Director: Philip Triggs, Director of Pensions and Treasury</p>	
<p>Report Author: Matt Hopson, Strategic Investment Manager</p>	<p>Contact Details: Tel: 0207 641 4126 E-mail: mhopson@westminster.gov.uk</p>

1. EXECUTIVE SUMMARY

1.1 This paper provides the Pensions Board Members a summary of:

- a. The two options for low carbon indices which were considered by the Pensions Sub-Committee, including a comparison and preferred option for the Fund.

2. RECOMMENDATIONS

2.1 The Board is requested to note:

- a. The Pensions Fund Sub-Committee's decision to transition its entire passive equity holdings from the MSCI All World Index to the MSCI World Low Carbon Target Index under the LGIM mandate.

3 BACKGROUND

- 3.1 The Pensions Sub-Committee was provided with several updates on low carbon options at the 23 July 2018 and 4 September 2018 meetings, including the FTSE Russell Low Carbon and the MSCI World Low Carbon indices.
- 3.2 Subsequently, the Sub-Committee commissioned Trucost to carry out a study on the Fund's carbon exposure. The headline figures from the report showed that the MSCI World Low Carbon Target Index contains, in absolute terms, 43 million tonnes of CO₂ (equivalent) less than the MSCI World Index at 28 million tonnes compared with 71 million tonnes.
- 3.3 As per the report taken to the Pensions Sub-Committee on 23 July 2018 and the graph below, the MSCI World Low Carbon Target Index has outperformed the MSCI World Index over a seven-year period.



- 3.4 The Pensions Sub-Committee was reminded of its fiduciary duties at the 23 July 2018 meeting and 4 September meeting:
- If decisions on carbon reduction are taken by the Sub-Committee, those decisions must be based on the likely positive investment outcome pertaining to the Pension Fund, and be not be based on any ethical approach or ideological attitude adopted either by the Sub-Committee or the local authority itself.*
- 3.5 By the fact that the MSCI World Low Carbon Target Index has outperformed the MSCI World Index over a seven-year cycle, it presented a compelling case for moving the portfolio to this index as part of an investment decision to secure better returns from the portfolio.
- 3.6 This investment-based decision would also mitigate some of the investment risk surrounding fossil fuel companies connected with the fears of “stranded assets” that was discussed at the 23 July 2018 Sub-Committee meeting.

- 3.7 The Pensions Sub-Committee was also presented with a further option in the FTSE Russell Low Carbon Index during the 4 September 2018 meeting, in which the Sub-Committee were able to ask questions.

4 INDEX SELECTION

- 4.1 Following on from the previous meetings, the Fund's investment consultant, Deloitte, met with FTSE Russell and prepared a short paper (attached as Appendix 1) on a comparison between the two managers.
- 4.2 The factors considered by the Sub-Committee in their choices are set out below:
- The MSCI World Low Carbon aims to keep returns close to the main index with regards to reducing carbon, whilst FTSE Russell Low Carbon tracks the FTSE All World.
 - The MSCI Word Low Carbon has a preferential fee rate with the Fund's existing provider, Legal and General.
 - The FTSE Russell World Low Carbon index takes account of green revenues within stocks such as Royal Dutch Shell and BP.
- 4.3 The Pensions Fund Sub-Committee took the decision to transition its entire passive equity holdings from the MSCI All World Index to the MSCI World Low Carbon Target Index under the existing LGIM mandate.

5 CONSULTATION

- 5.1 Not applicable

6 EQUALITY IMPLICATIONS

- 6.1 Not applicable

7 LEGAL IMPLICATIONS

- 7.1 The Sub-Committee's fiduciary duties are discussed in the main body of the report.

8 FINANCE AND RESOURCES IMPLICATIONS

- 8.1 None

9 IMPLICATIONS FOR BUSINESS

- 9.1 Not applicable

10 RISK MANAGEMENT

- 10.1 The selection of a different index to the current passive equity mandate could potentially lead to different levels of investment risk. As the Low Carbon indices

broadly seek to match the return of the major global index, there is not anticipated to be a material additional investment risk to the portfolio.

10.2 The reduction in volatile commodity stocks could reduce volatility and therefore risk over the longer term.

10.3 There are currently eight local authorities invested in the MSCI Low Carbon index including five London Boroughs: Ealing, Haringey, Tower Hamlets, Islington and Southwark. The Fund value is just over £2bn.

11 PROCUREMENT IMPLICATIONS

11.1 None

12 IT STRATEGY IMPLICATIONS

12.1 None

LIST OF BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
1.			

LIST OF APPENDICES:

Appendix 1: Low Carbon Indices Comparison

Appendix 2: Low Carbon Exposure Strategy

Appendix 3: Equity Strategy



Low Carbon Indices

London Borough of Hammersmith &
Fulham Pension Fund

November 2018

1 Introduction

This paper has been prepared for the Pensions Sub-Committee ("the Sub-Committee") of the London Borough of Hammersmith & Fulham Pension Fund ("the Fund"). The purpose of this paper is to provide the Sub-Committee with information on two low carbon indices, more specifically:

- The MSCI World Low Carbon Target Index; and
- The FTSE All-World ex CW Climate Index.

This paper will also provide details on implementation offerings available for each index through Legal & General for the MSCI index and DWS and StateStreet Global Advisors ("SSgA") for the FTSE Russell index.

2 What are the options?

2.1 MSCI World Low Carbon Target Index

Details

The MSCI Low Carbon indices were developed to address the requirement for investors to target a passive option with a lower 'carbon footprint' than traditional market-cap weighted indices. The MSCI World Low Carbon Target Index is designed to:

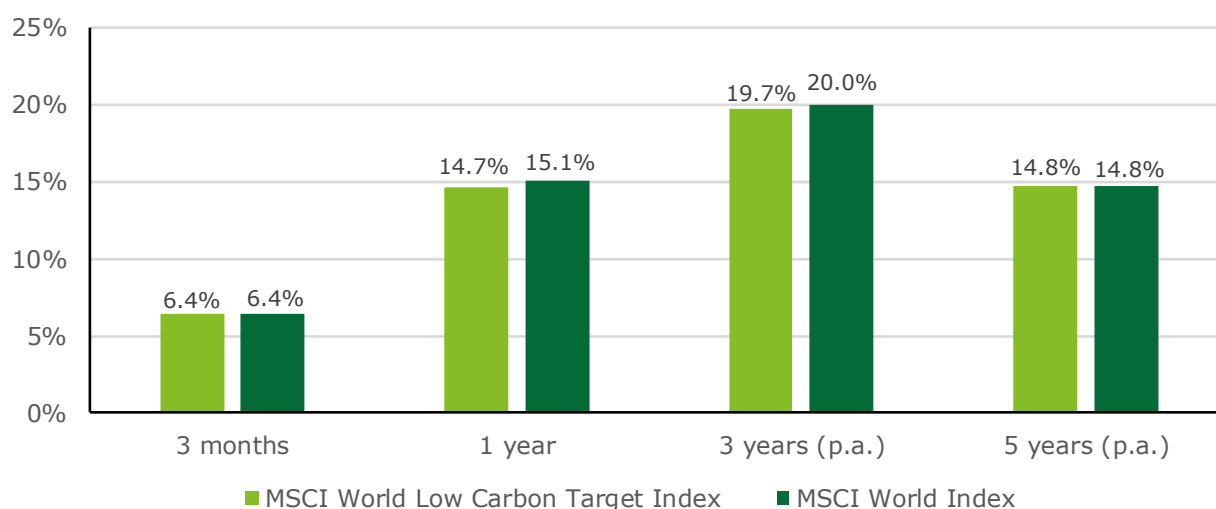
- reduce exposure to carbon emitting companies, measured in current carbon emissions (relative to sales) and potential emission from future fossil fuel reserves (per dollar of market capitalisation); and
- to maintain global equity exposure with close tracking to the MSCI World Index.

The emissions data is produced by MSCI and is based on data from annual reports, corporate social responsibility reports, the Carbon Disclosure Project (an organisation which runs a global disclosure system that enables companies, cities, states and regions to disclose greenhouse gas emissions), oil and gas industry bodies and other relevant third-party sources.

The constituents of the Index are selected from the parent (MSCI World) index using MSCI's optimisation process. This process seeks to minimise the carbon exposure of the constituents of the index relative to the parent index, whilst also aiming for a 0.30% cap on the tracking error. The optimisation process also seeks to limit the extent to which the weightings of the companies, sectors and countries represented in the index differ from the weightings of those companies, sectors and countries in the parent index. The weight of each company in the index will not exceed 20 times its weight in the MSCI World Index and the weight of each country and sector represented in the index will not deviate more than 2% (upwards or downwards) from its weighting in the MSCI World Index (with the exception of the energy sector, where no such constraint is applied).

Performance

Performance of the MSCI World Low Carbon Target Index versus the MSCI World Index is shown in the graph below. The MSCI World Low Carbon Target Index has consistently tracked the MSCI World Index over all periods to 30 September 2018.



Source: MSCI Low Carbon Target Index Factsheet

LGIM MSCI Low Carbon Target Fund

The LGIM fund aims to track the performance of the MSCI World Low Carbon Target Index (less withholding tax where applicable) to within +/- 1.00% p.a. for two years out of three.

The fund employs an index tracking strategy, aiming to replicate the performance of its MSCI based benchmark. LGIM follows a pragmatic approach to managing index funds, either investing directly in the securities of that index, or indirectly through other LGIM funds. The fund may also hold index and single stock futures for efficient portfolio management.

The LGIM MSCI World Low Carbon Target Index Fund has 7 LGPS clients in total (across unhedged and currency hedged share classes), with a total AuM of c. £2.1bn as at 30 September 2018.

The Fund would be subject to the following discounted LCIV flagship Low Carbon fee:

London Borough of Hammersmith and Fulham would be charged:

- an Annual Management Charge (AMC) of 0.02%; and
- On Fund Costs (OFC) of 0.0476%.

This equates to a total of 0.0676% TER, inclusive of license fee.

An additional 2.5bps will be applied to the AMC for currency hedging if required.

2.2 FTSE Russell All-World ex CW Climate Index Details

The FTSE Russell All-World ex CW Climate index focuses on achieving sustainable returns, taking into account:

- Fossil fuel reserves;
- Operational carbon emissions; and
- Green revenues.

The index places emphasis on being underweight companies with fossil fuel reserves and overweight green revenue companies i.e. companies engaged in the transition to a green economy. Regarding operational carbon emission, the index will seek to be underweight companies with high greenhouse gas emissions.

The FTSE Russell All-World ex CW Climate index selects resources from the parent FTSE Russell All-World index and uses its internal Sustainable Investment Data ("SID") platform to assess the levels of green revenue of each stock. The index aims to collect the broadest possible range of green revenues, with green revenues classified based on the following sub sectors:

- Energy generation;
- Energy equipment;
- Energy management;
- Energy efficiency;
- Operational shift;
- Modal shift;

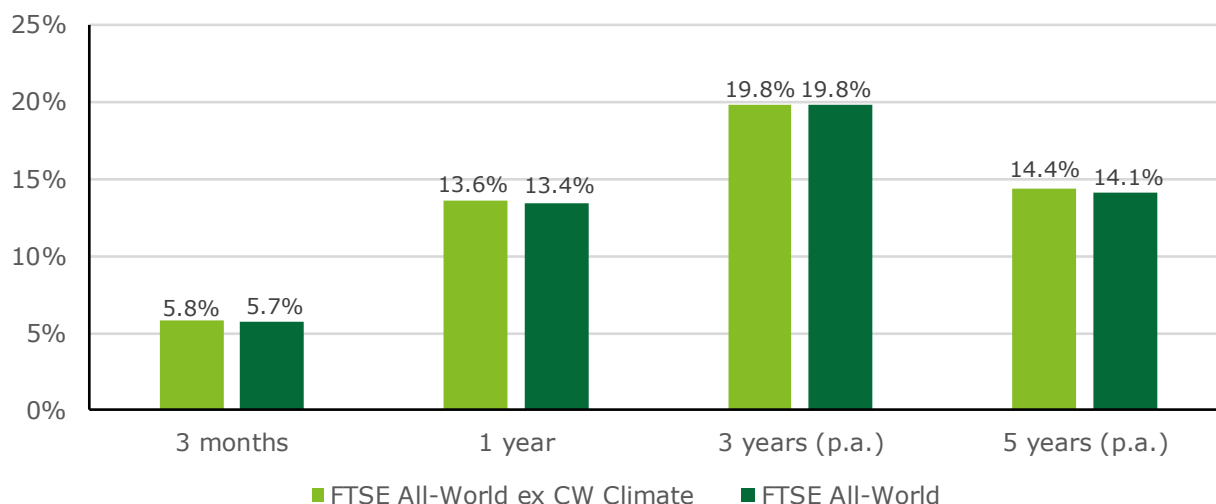
- Environmental resources; and
- Environmental infrastructure.

Information is taken from company annual reports, ESG reports and other sources such as Trucost, who are used as a provider of carbon emission reporting on specific companies. However reporting in this area is not widely formalised and therefore the data can often be inconsistent or incomplete. The SID platform therefore provides estimated green revenues generated by each company and where a range is provided, FTSE will always assume the lower end of this range.

Unlike the MSCI index described above, the FTSE Russell ex CW Climate index does not incorporate a cap on the tracking error regarding the performance or sector/stocks held in the index versus the parent index.

Performance

Performance of the FTSE Russell All-World ex CW Climate Index versus the FTSE Russell All-World Index is shown in the graph below. The FTSE Russell All-World ex CW Climate Index has consistently tracked the FTSE Russell All-World Index over all periods to 30 September 2018.



Source: FTSE Russell All-World ex CW Climate Index Factsheet

Implementers

Legal & General currently do not offer a fund that tracks this index. When setting up any new fund, LGIM must satisfy various criteria such as seed AuM, multi-investor pipeline, product approval and fee discussions. We therefore asked FTSE Russell to propose implementation options that they have used for this index. It should be noted that these terms are indicative and the Fund would need to engage with any implementation provider separately to confirm such terms. FTSE Russell have had the following indicative quotes:

- DWS – 4bps fee subject to a £75k minimum. This does not include operational fees and expenses.
- StateStreet Global Advisors – 8-12bps fee.

With both providers, there would be an additional 2.5bps index fee.

3 Conclusion

3.1 Performance

Performance figures as at 30 September 2018 for the MSCI World Low Carbon Target Index and the FTSE Russell All-World ex CW Climate Index are given in the table below.

Index	3 months (%)	6 months (%)	1 year (%)	3 years p.a. (%)	5 years p.a. (%)
MSCI World Low Carbon Target Index	6.4	14.9	14.7	19.7	14.8
FTSE Russell All-World ex CW Climate Index	5.8	13.3	13.6	19.8	14.4

The MSCI World Low Carbon Target Index has outperformed the FTSE Russell All-World ex CW Climate Index over the 3 months, 6 months and 12 months periods to 30 September 2018. Over the longer periods, the returns of the two indices are similar on a per annum basis with the MSCI index slightly outperforming the FTSE index by 0.4% p.a. over the 5 year period.

3.2 Implementation

DWS are a passive provider based in Europe with over €119bn of passive assets under management however are not commonly used within the UK Pension Scheme market. StateStreet Global Advisors ("SSgA") are one of the key index providers in the UK and Global market. With both managers, there is no pooled fund available and therefore the Fund would need to open a standalone mandate with the provider.

The Fund's current passive equity allocation is with LGIM and therefore moving to the MSCI Low Carbon fund would not involve any on-boarding documentation or set-up work. There is also the benefit of a preferential fee agreement with the London CIV. The Sub-Committee should look to understand to what extent LGIM could move the mandate in-specie, and therefore to what extent transition cost savings could be achieved from this approach.

3.3 Overall view

As we outlined in our previous paper to the Sub-Committee, "Carbon Exposure", there is the theory to suggest that carbon intensive companies will be negatively impacted as society moves towards a 'greener', low-carbon world. We believe that it is hard to predict when this change may happen, with there being very little historic evidence to suggest that adopting a more "carbon aware" approach to investment delivers better risk adjusted returns. That said, we do believe that any carbon strategy must focus on those investments that are likely to benefit from a low carbon regulatory environment and the Fund should seek to gain exposure to such assets, as well as avoiding those that are likely to be negatively impacted.

The main difference between the FTSE Russell All-World ex CW Climate Index and the MSCI World Low Carbon Target Index is that FTSE are taking green revenues into account, looking for overweight exposure to companies that are generating green revenues. However, given the lack of formal reporting requirements to report on carbon emissions, information is often inconsistent, incomplete and lacking in quality. Therefore FTSE's data collection process is very manual and data interpretation is more time consuming than we would usually see with a passive approach (which should be largely rules based). We expect this to change in the future as reporting requirements become more formalised.

For the reasons above, as well as taking into account implementation, product availability and fees, we feel that the MSCI Low Carbon Target Fund with LGIM is a more appropriate lower carbon option for the Fund.

Risk Warnings

- Past performance is not necessarily a guide to the future.
- The value of investments may fall as well as rise and you may not get back the amount invested.
- Income from investments may fluctuate in value.
- Where charges are deducted from capital, the capital may be eroded or future growth constrained.
- Investors should be aware that changing investment strategy will incur some costs.
- Any recommendation in this report should not be viewed as a guarantee regarding the future performance of the products or strategy.

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Carbon Exposure

London Borough of Hammersmith and
Fulham Pension Fund

June 2018

1 Executive Summary

This paper has been prepared for the Pensions Sub-Committee ("the Sub-Committee") of the London Borough of Hammersmith & Fulham Pension Fund ("the Fund"). The purpose of this paper is to provide the Sub-Committee with information on the Fund's investment exposure to fossil fuels, the potential risks this may cause and the options available to mitigate this risk.

This paper should be read in conjunction with the Equity Portfolio Review paper, which provides detail on alternative passive equity strategies which track a low carbon index.

The Sub-Committee should also liaise with the London CIV to understand if it is looking to implement a solution in this space.

2 Defining Carbon Exposure

2.1 Introduction

'Carbon footprint' is a term used to quantify the exposure a stock or portfolio may have to fossil fuels, however there is no agreed method on how this footprint should be measured. A simple method at the portfolio level is to analyse the **carbon emissions** of each company within a portfolio.

However carbon emissions may not be the best measure, albeit probably the simplest. A change in policy or change in society which impacted or even restricted the use of fossil fuels would more likely affect companies who own fossil fuel assets. This is known as **carbon reserves**.

2.2 Carbon Emissions

Carbon emissions can be split into the following three types:

- Scope 1: All direct greenhouse gas emissions from sources owned or controlled by the company.
- Scope 2: Indirect greenhouse gas emissions from consumption of purchased electricity, heat, or steam.
- Scope 3: Other indirect emissions that occur from sources not owned or controlled by the company. This includes extraction and production of purchased materials; transportation of purchased fuels; and use of sold products and services.

As would be expected, the oil and gas and utilities sectors have significant direct and indirect emissions, whilst food retailers for example generate significant emissions as part of their supply chain. An investment portfolio that tracks a market capitalisation based index (such as the FTSE All World that the Fund invests in), where developed markets dominate and consequently contain a significant proportion of energy-related holdings, will have substantial exposure to carbon-intensive companies.

2.3 Carbon Reserves

Carbon emissions, defined above, give the current level of impact that companies have. However, a change in policy or change in society which impacted or even restricted the use of fossil fuels would more likely affect companies with high carbon reserves (fossil fuel assets owned by companies that are still in the ground to be extracted and sold on) as opposed to current emissions. Current emissions can be quickly changed and companies can adapt whereas companies with fossil fuel reserves are likely to experience a greater impact from such a change in policy. Naturally, companies in the oil and gas and basic materials sectors will have the greatest exposure by this measure

2.4 Measuring Carbon Exposure

One of the major issues with measuring carbon emissions is that company disclosure is voluntary in many jurisdictions and when there are gaps, data

providers are required to make assumptions. Scope 1 and 2 emissions are disclosed relatively widely but scope 3 less so, with the disclosure methodology varying between companies and industries.

Largely, the main source of information on carbon emissions is through publicly available information such as annual reports, financial reports, corporate social responsibility or environmental reports and company websites.

Furthermore, with the companies that do disclose carbon emissions, there is often a quality issue regarding the information. In many regions, carbon disclosure remains voluntary and is not always audited by external third parties, therefore there is a variation in disclosure amongst different companies and sectors.

Lastly, it is important to note that carbon footprint should not only be measured on the basis of negative impact. New innovations are transforming the way we generate, store and consume energy and the argument could be made that companies that are involved in this transformation are likely to benefit (in the same way that carbon intensive companies are likely to suffer) from political and social change.

3 What are the risks?

3.1 Investment Risks

Pension schemes, particularly within the public sector, are increasingly being encouraged to consider their exposure to fossil fuels and the potential risks associated with fossil fuel investments. The investment arguments are:

- Fossil fuels are contributing to climate change and greater onus is being put on organisations to control their emissions of greenhouse gases.
- Given the non-sustainability of fossil fuels, companies which are run with “carbon-intensive” operations are at risk of not being able to sustain their operations in the future. When this point in the future may be is unknown, as it is hard to measure the rate at which societies around the world will make the transition to a “clean” or low carbon energy mix. However, if a company’s sustainability is in question, the investment return of its shares are expected to be directly affected over the longer term.

The Paris Agreement, adopted at the Paris Climate Conference in 2015, is the first legally binding global climate deal which sets out a plan to avoid dangerous climate change by limiting global warming to “well below” 2 degrees Celsius above pre-industrial levels. Assuming this Agreement is upheld this will have a big impact on the use (or non-use) of the current carbon reserves.

This creates the risk of ‘stranded assets’ i.e. companies with fossil fuel reserves, whose assets are valued much lower, impacting on the valuation and therefore share price of the company.

Secondly, energy is often one of the biggest costs businesses face and being a commodity, it is exposed to volatile price fluctuations. Companies with high exposure to fossil fuels are therefore at risk. Price change as a result of political or social impact (for example carbon taxes) could result in a significant change to a company’s operating costs, resulting in an impact in the share price valuation.

4 What are the options?

4.1 Assessing the carbon exposure

There has been a recent trend of investors moving from reporting of carbon exposure to actively attempting to manage / reduce the exposure. In response, the asset management industry have developed investment solutions both actively managed, and passively managed (with the development of new benchmarks by index providers).

A number of data suppliers offer carbon portfolio analysis systems and bespoke reports on an investment portfolio in order to assist investors with carbon footprint and climate risk measurement and reporting.

4.2 The Equity Portfolio

Equities is much easier to assess than other assets, and is likely to be the first to be affected in the event of change. With equity investments, there are a number of options available:

- Negative screening – exclude stocks based on fossil fuel exposure and carbon based measures.
- Positive screening – selects companies that have best climate credentials.
- Thematic – focus on themes such as clean technology.
- Active ownership – investing and engaging with companies.

4.3 MSCI Low Carbon

The MSCI Low Carbon indexes were developed to address carbon emissions and carbon reserves and have seen increasing interest from investors over the past couple of years. The MSCI World Low Carbon Target Index is designed to:

- reduce exposure to carbon emitting companies, measured in current carbon emissions (relative to sales) and potential emission from future fossil fuel reserves (per dollar of market capitalisation); and
- to maintain global equity exposure with close tracking to the MSCI World Index.

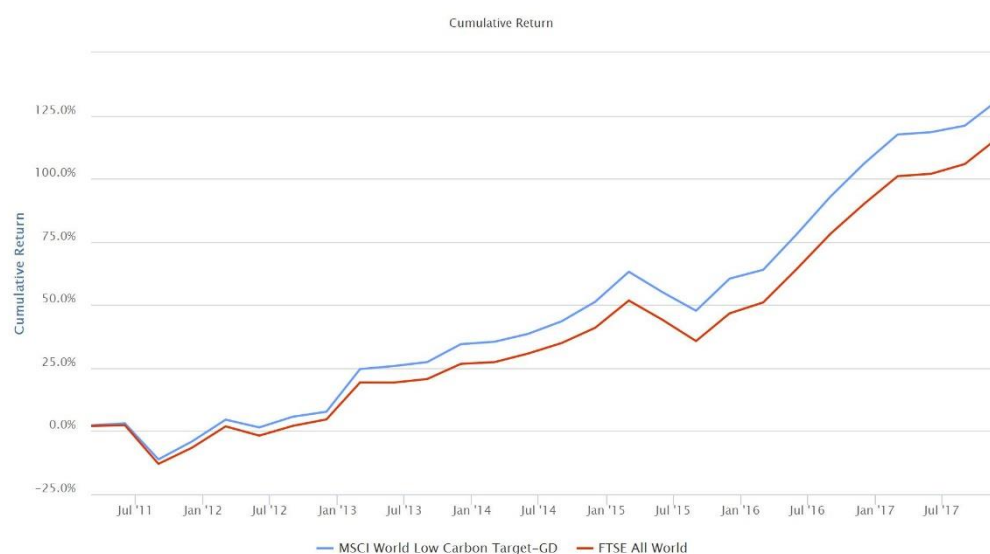
The emissions data is produced by MSCI and is based on data from annual reports, corporate social responsibility reports, the Carbon Disclosure Project (an organisation which runs a global disclosure system that enables companies, cities, states and regions to disclose greenhouse gas emissions), oil and gas industry bodies and other relevant third-party sources.

The constituents of the Index are selected from the parent (MSCI World) index using MSCI's optimisation process. This process seeks to minimise the carbon exposure of the constituents of the index relative to the parent index, whilst also applying a 0.30% cap on the tracking error. The optimisation process also seeks to limit the extent to which the weightings of the companies, sectors and countries represented in the index differ from

the weightings of those companies, sectors and countries in the parent index. The weight of each company in the index will not exceed 20 times its weight in the MSCI World Index and the weight of each country and sector represented in the index will not deviate more than 2% (upwards or downwards) from its weighting in the MSCI World Index (with the exception of the energy sector, where no such constraint is applied).

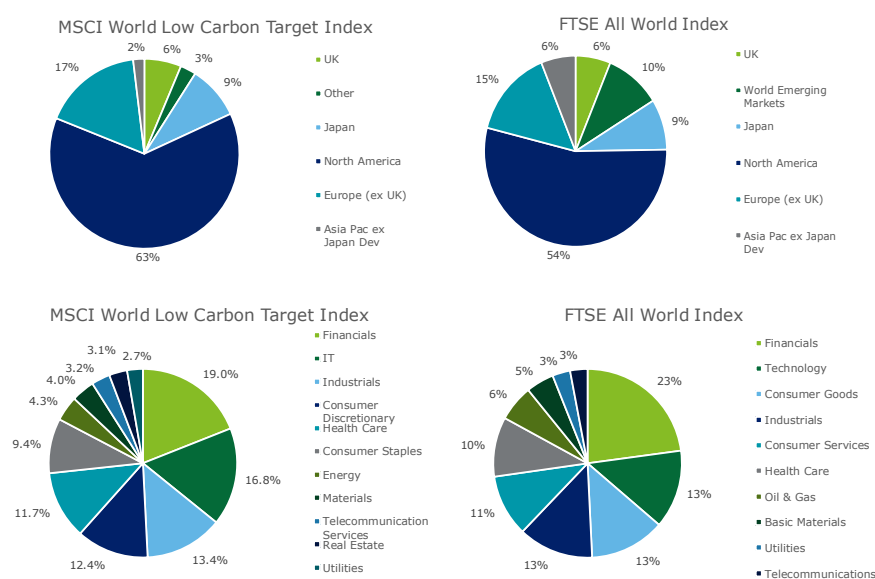
4.3.1 Performance

The FTSE All-World Index has outperformed the MSCI World Low Carbon Target Index over all periods considered since August 2015. However, when considering the cumulative quarterly return from Q1 2011 to Q4 2017, the MSCI World Low Carbon Target Index has outperformed the FTSE All-World Index, as can be viewed in the chart below.



4.3.2 Asset allocation

The country and sector breakdown for the two indexes as at 31 December 2017 are given below.



The two indexes have comparable allocations to European (ex UK), UK and Japanese equity markets. The MSCI World Low Carbon Target Index however has a higher allocation to North America, with a lower allocation to Asian and emerging markets.

4.3.3 Additional details

The table below gives details of the number of stocks comprising each index.

	MSCI World Low Carbon Target Index	FTSE All-World Index
Number of stocks	1225	3167

As at 31 December 2017, the MSCI World Low Carbon Target Index contained c. 40% of the number of stocks in the FTSE All-World Index. The Low Carbon Index is therefore a more concentrated portfolio although is still significantly more diversified than alternative low carbon solutions.

5 Conclusion

In this paper we have outlined how fossil fuel exposure can be defined within an investment portfolio. However given the lack of formal reporting requirements to report on carbon emissions, information is often inconsistent and lacking quality. Therefore establishing the 'carbon footprint' of a given company is challenging. There are data providers who can assist investors to better understand their portfolio's carbon footprint by providing bespoke reports and analysis on a given investment portfolio.

The majority of the Fund's investments is within pooled funds and therefore there is little scope for the Sub-Committee to alter the investments within these funds. Should the Sub-Committee wish to make any divestment decisions, it is important to highlight and consider its key fiduciary responsibility which is to manage the investments in the interests of the members, where the focus is on generating the best risk adjusted return.



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London Borough of Hammersmith and Fulham Equity Portfolio Review

Introduction

This note has been prepared for the Pensions Sub-Committee ("the Sub-Committee") of the London Borough of Hammersmith & Fulham Pension Fund ("the Fund"). The purpose of this paper is to provide the Sub-Committee with a review of the Fund's equity holdings and potential points to consider.

Current Equity Allocation

The table below shows the Fund's current allocation versus the strategic benchmark allocation.

Asset Class	31 March 2018	31 March 2018	Benchmark Allocation	Relative Allocation
Majedie	£159.1m	16.0%	15.0%	1.0%
<i>UK Equity Fund (LCIV)</i>	<i>£125.2m</i>	<i>12.6%</i>		
<i>UK Focus Fund</i>	<i>£19.9m</i>	<i>2.0%</i>		
<i>Tortoise Fund</i>	<i>£14.0m</i>	<i>1.4%</i>		
LGIM World Equity	£303.2m	30.4%	30.0%	0.4%
Total	£462.3m	46.4%	45.0%	1.4%

At the start of the year the Sub-Committee carried out an equity rebalancing exercise, disinvesting £60m from Majedie and invested the proceeds with Ruffer, albeit the funds were to be used to fund capital calls for the Partners Group and Aviva infrastructure funds over the longer term. As a result of this, the Fund's strategic benchmark within the equity portfolio changed to 67% LGIM, 33% Majedie (from 50/50).

As at 31 March, the Fund was slightly overweight its equity allocation, however we see the main issues to be addressed as being:

1. The exposure to the UK equity market; and
2. Whether a low carbon alternative would be more suitable than the current passive global equity mandate.

UK Market Exposure

Majedie's UK equity fund and focus fund is benchmarked against the FTSE All-Share Index. Although mostly UK stocks, both funds have flexibility to invest up to 20% in shares listed outside of the UK. As at 31 March, 32.5% of the Fund's total equity allocation was invested in UK stocks, whereas c. 6% of the global equity index is invested in UK stocks.

This analysis excludes the Tortoise Fund which is an equity long/short fund targeting a positive absolute return regardless of how the equity market is performing. In managing the portfolio, Majedie has scope to adjust the extent to which the portfolio retains market directional exposure (beta) and can therefore potentially 'short' the market.

With questions over the outlook for economic growth and the uncertainty around the implications of the UK's exit from the EU, the Sub-Committee should give thought as to whether this overweight exposure to the UK equity market is appropriate going forward.

Exposure to Carbon

In our separate 'Carbon Exposure Report' we discuss the potential risks associated with fossil fuel investments and options to mitigate this risk. One option relating to the passive equity exposure is to select a different index for the fund to track. The MSCI Low Carbon Target Index was developed to address the growing concern from investors about their investment in fossil fuels and the recent trend to reduce their exposure. Two of the largest index tracking fund managers (Legal and General and BlackRock) have products available which track the MSCI Low Carbon Target Index. Further details on each of these funds are given below.

LGIM World Low Carbon Target Index Fund

The Fund aims to track the performance of the MSCI World Low Carbon Target Index to within +/- 1% p.a. for two years out of three. This is an optimized strategy that develops the lowest attainable carbon portfolio within the 0.30% tracking error budget to the parent MSCI World Index.

Fund Launch Date	August 2015
AuM (as at 31 December 2017)	£1,002m
Fees	0.220% per annum of the first £5 million, plus 0.195% per annum of the next £10 million, plus 0.170% per annum of the next £35 million, plus 0.145% per annum of the balance above £50 million The LGPS rate is 7.94% TER flat fee. This is split by AMC of 2.75% and OFC of 5.19% - of which license fee is included.

BlackRock Authorised Contractual Scheme (ACS) World Low Carbon Equity Fund

The Fund aims to track the MSCI World Low Carbon Target Index. The index aims for a tracking error target of 0.30% relative to the MSCI World Index while minimizing the carbon exposure by up to 80%.

Fund Launch Date	December 2017
AuM (as at 31 December 2017)	£168m
Fees	AMC of 0.20%. Admin and custody expenses were 0.02% at the end of February 2018.

LGIM Future World Fund

An alternative strategy that clients could consider is the LGIM Future World Fund, which focusses on wider climate risk as opposed to solely carbon exposure. This Fund aims to capture the transition to a low carbon economy by having a lower exposure to companies with worse than average carbon emissions and fossil fuel assets, and higher exposure to companies that generate revenue from low carbon opportunities.

The objective of the Fund is to replicate the performance of the FTSE All-World ex CW (Controversial Weapons) Climate Balanced Factor Index (which LGIM worked with FTSE-Russell to create) whilst not necessarily holding all of the constituents. The anticipated annual tracking error relative to the Index is +/-0.60% in two years out of three.

As part of LGIM's Climate Impact Pledge, it ranks and analyses c. 90 companies. LGIM actively engages with companies with low scores for a period of one year and if no change is observed the company is added to the list to be disinvested from the Fund. LGIM will publish the list of disinvested companies, as well as the market leaders, on a semi-annual basis. The public nature of these announcements will only improve company engagement.

Conclusion

UK Market Exposure

While we rate Majedie and the portfolio managers responsible for all three products, we would question the Fund's need for such a large (relative) allocation to the UK equity market given current concerns. We would also question the Fund's need for a concentrated active UK Equity portfolio (the Focus Fund), the performance of which is correlated to the larger mandate (the Equity Fund).

Considering both points, we would be supportive of a reduction in the Majedie exposure, taking from the Focus Fund in the first instance. This would be used to increase the Fund's global equity allocation, keeping the total equity exposure the same at 45%. The Sub-Committee may also wish to consider the benefits of the Tortoise mandate, given the other diversifying strategies within the Fund's investment portfolio.

Exposure to Carbon

Recognising the importance of this issue, we would encourage the Sub-Committee to gain a greater understanding of the Fund's overall 'carbon footprint'. The MSCI Low Carbon Target Index would be an appropriate replacement for the FTSE All World, the index the current passive equity mandate tracks, given the reduced exposure to fossil fuels as well as the similarities of performance. It should be noted that there are alternative strategies, such as the Future World Fund, which could also suit the needs of the Fund depending on the overall objective towards fossil fuel and sustainable investment.

Deloitte Total Reward and Benefits Limited
June 2018

Risk Warnings

- Past performance is not necessarily a guide to the future.
- The value of investments may fall as well as rise and you may not get back the amount invested.
- Income from investments may fluctuate in value.
- Where charges are deducted from capital, the capital may be eroded or future growth constrained.
- Investors should be aware that changing investment strategy will incur some costs.
- Any recommendation in this report should not be viewed as a guarantee regarding the future performance of the products or strategy.

Our advice will be specific to your current circumstances and intentions and therefore will not be suitable for use at any other time, in different circumstances or to achieve other aims or for the use of others. Accordingly, you should only use the advice for the intended purpose.



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Agenda Item 10

London Borough of Hammersmith & Fulham PENSIONS BOARD 6 February 2018		 hammersmith & fulham
CHANGES TO EMPLOYEE PENSIONS CONTRIBUTION BANDINGS CALCULATIONS		
Report of the Strategic Director, Finance and Governance		
Open Report		
Classification - For Information		
Key Decision: No		
Wards Affected: None		
Accountable Director: Phil Triggs, Tri Borough Director of Pensions and Treasury		
Report Author: Matt Hopson, Strategic Investment Manager		Contact Details: Tel: 0207 641 4126 E-mail: mhopson@westminster.gov.uk

1. EXECUTIVE SUMMARY

- 1.1 This report provides an update of any financial impacts to the Pension Fund resulting from changes to pensions contributions, arising from the move to the Hampshire County Council Integrated Business Centre (IBC).
- 1.2 The two impacts to the fund will be the changes to how employee contribution bandings are calculated and the effect of auto-enrolment for some employees where opt out dates are not held.

2. RECOMMENDATIONS

- 2.1 The Board is recommended to note this update.

3 CHANGES TO EMPLOYEE CONTRIBUTION RATES

- 3.1 Employee contributions are defined in the LGPS regulations and the contribution framework does not vary between Funds. The total salary of an employee, including one off payments and overtime, is used to calculate how much each employee should be contributing. This is shown in the table below:

If your actual pensionable pay is:	You pay a contribution rate of:
Up to £14,100	5.5%
£14,101 to £22,000	5.8%
£22,001 to £35,700	6.5%
£35,701 to £45,200	6.8%
£45,201 to £63,100	8.5%
£63,101 to £89,400	9.9%
£89,401 to £105,200	10.5%
£105,201 to £157,800	11.4%
£157,801 or more	12.5%

- 3.2 Whilst the values above are fixed, it is up to individual administering authorities to calculate what they deem an employee's pensionable pay to be. The system that was in place under BT, determined annual pay on a monthly basis, calculated by grossing up one month's salary twelve times.
- 3.3 For example, an employee who earned a flat £2,000 per month will be calculated to have an annual salary of £24,000, placing them in the 6.5% banding which will be applied to their salary each month, costing the individual £130 per month. The problem with this, is the calculation does not take into account one off payments.
- 3.4 If we take the example of the same employee paid £2,000 per month but they receive a one-off overtime payment of an additional £2,000 in May, the calculation will deem their annual salary to be £48,000 $((£2,000 + £2,000) \times 12)$. Despite the fact the employee only earns £26,000 for the year and should pay the 6.5% contribution rate, in the month of May only they will be charged 8.5%, thus incurring an effective overpayment of £80.
- 3.5 The IBC solution works in a different way so that it takes base salary for the year plus a rolling twelve month look at any one-off payments to determine the contribution banding. In the example above, the employee would pay 6.5% for the year.
- 3.6 Although this means many people may pay less contributions, it could mean that others pay more. If we take another example of an individual earning £3,500 per month, they have a base salary of £42,000 and will pay 6.8% contributions. If they receive one off overtime / bonus payment in the month of May of £4,000 the IBC solution will calculate their salary as being £46,000 and the individual will pay 8.5% on their entire salary for the next twelve months - £3,910 per annum.
- 3.7 If the same individual had been paid under the BT payroll, in the month of May they would have their salary grossed up to £90,000 and pay 10.5% (£787.50) but would only pay 6.8% for the remainder of the year (£2,618). This individual would pay a total of £3,405.50, which means they are paying £504.50 more under the IBC solution.

- 3.8 Clearly there will be winners and losers from the change in system, but the new method is a fairer, more equitable solution for both the Fund and Members as it more effectively calculates annual salary for pensions banding purposes.

4 AUTO ENROLEMENT

- 4.1 Members are automatically enrolled onto the pension scheme when they commence employment, assuming they meet the minimum salary criteria and are between the age of 22 and the state pension age.
- 4.2 Employees have the right to opt out of the scheme if they wish, by signing an opt out form.
- 4.3 A small number of employees have opted out of the scheme (around 200 in total across the Tri-Borough) where their opt out dates and forms are not held in Agresso. These individuals will be auto enrolled when their payroll data is transferred to the New Hampshire payroll system, meaning they will restart paying pension contributions.
- 4.4 These employees will need to opt out again if they still wish to remain out of the fund. All employees who will be auto enrolled under the migration will be notified accordingly.

5 FINANCIAL IMPACTS

- 5.1 The financial impact to the Fund of changing the contributions calculation method is expected to be largely negligible as some employees will pay less in contributions and others will pay more. It is very difficult to estimate whether net contributions will go up or down due to the complexities surrounding this.
- 5.2 The financial impact to the Fund of the auto enrolment will potentially mean a negligible gain if the newly opted in individuals continue to pay into the Fund, but if the affected members all opt out, then there will be no impact.

6 CONSULTATION

- 6.1 Not Applicable

7 EQUALITY IMPLICATIONS

- 7.1 Not applicable

8 LEGAL IMPLICATIONS

- 8.1 None

9 FINANCE AND RESOURCES IMPLICATIONS

- 9.1 None

10 IMPLICATIONS FOR BUSINESS

10.1 Not applicable

11 RISK MANAGEMENT

10.1 None

12 PROCUREMENT IMPLICATIONS

12.1 None

13 IT STRATEGY IMPLICATIONS


13.1 None

LIST OF BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
	None		

LIST OF APPENDICES:

Agenda Item 11

London Borough of Hammersmith & Fulham PENSIONS BOARD 6 February 2019		
PIRC PERFORMANCE REPORT 2017/18		
Report of the Strategic Director of Finance & Governance		
Open Report		
Classification – For Information		
Key Decision: No		
Wards Affected: None		
Accountable Director: Phil Triggs, Director of Pensions and Treasury		
Report Author: Matt Hopson, Strategic Investment Manager Tim Mpofu, Pension Fund Manager		Contact Details: Tel: 0207 641 6308 E-mail: tmpofu@westminster.gov.uk

1. Executive Summary

- 1.1. The purpose of this paper is to update the Pensions Board on the investment performance of the fund during the financial year 2017/18. The paper also reports on performance over the longer term alongside other local government pension funds (LGPS).
- 1.2 This paper should be read in conjunction with the LBHF Pension Fund Performance Summary 2017/18 paper from PIRC which has been included at Appendix 1. The PIRC paper reports the Fund's performance in greater detail.

2. Recommendations

- 2.1 The Pensions Board is recommended to note this report.

3. Investment Performance 2017/18

- 3.1 The average local authority fund produced a return of 4.5% in 2017/18. In comparison, LBHF Pension Fund produced 1.7% which ranked in the 95th percentile.

- 3.2 The reason for the comparably lower return was due, in part, to the Fund's lower equity exposure which had a large drag on LBHF Pension Fund when compared with relative local authority performance. The Fund currently has a significant exposure to UK Equities which were substantially outperformed by Global Equities, returning only 1.4%. The Fund had relatively low equity exposure compared with the wider LGPS which averaged 55%.
- 3.3 In addition active management saw a 2% higher level of return on average when compared with passive equity, whilst the Fund has no allocation to global active equity.
- 3.3 The best performing major asset class was Property for which the fund has a 5% allocation. This returned an average of 10% during the financial year. Private Equity also performed strongly producing a return of 9% for the year. The fund currently has 1% exposure to this asset class, again contributing to lower relative returns.
- 3.4 Despite relatively strong performance in the equity class, local authority equity exposure experienced a large move out of this category as LGPS funds continued to reallocate to less 'risky' assets. There has also been a focus on income generating assets as many funds are now faced with the arrival of negative cash flow.

4 Longer Term Results

- 4.1 The average LGPS fund delivered an annualised performance of 9% per annum driven largely by strong long-term equity performance. Bonds have also performed well over the longer term assisted by 'quantitative easing'.
- 4.2 However, equities still remain the largest asset allocation within most funds' assets and about 75% of this equity allocation is now invested in Global Equities.
- 4.3 The LBHF Pension Fund has a significantly lower equity allocation and much higher bond allocation when compared to the structure of the average LGPS fund. This had a relatively negative impact on the investment performance in 2017/18.
- 4.4 However, long-term performance over the ten-year period remains extremely good and performance over all reported periods has out-performed both inflation and actuarial assumptions.
- 4.5 Funds typically get rewarded for exposure to higher risk. However, the LBHF Pension Fund has managed to deliver a much higher long-term return than average at a relatively low level of volatility. This is the optimal combination which would suggest strong fund stewardship over the long term.
- 4.8 Further details of the fund performance are attached to Appendix 1 to this report.

5 CONSULTATION

5.1 Not Applicable

6 EQUALITY IMPLICATIONS

6.1 Not applicable

7 LEGAL IMPLICATIONS

7.1 None

8 FINANCE AND RESOURCES IMPLICATIONS

8.1 Set out within the main report.

9 IMPLICATIONS FOR BUSINESS

9.1 Not applicable

10 RISK MANAGEMENT

10.1 Set out within the main report.

11 PROCUREMENT IMPLICATIONS

11.1 None

12 IT STRATEGY IMPLICATIONS

12.1 None

LIST OF BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name of holder of file/copy	Department/ Location
1.	None		

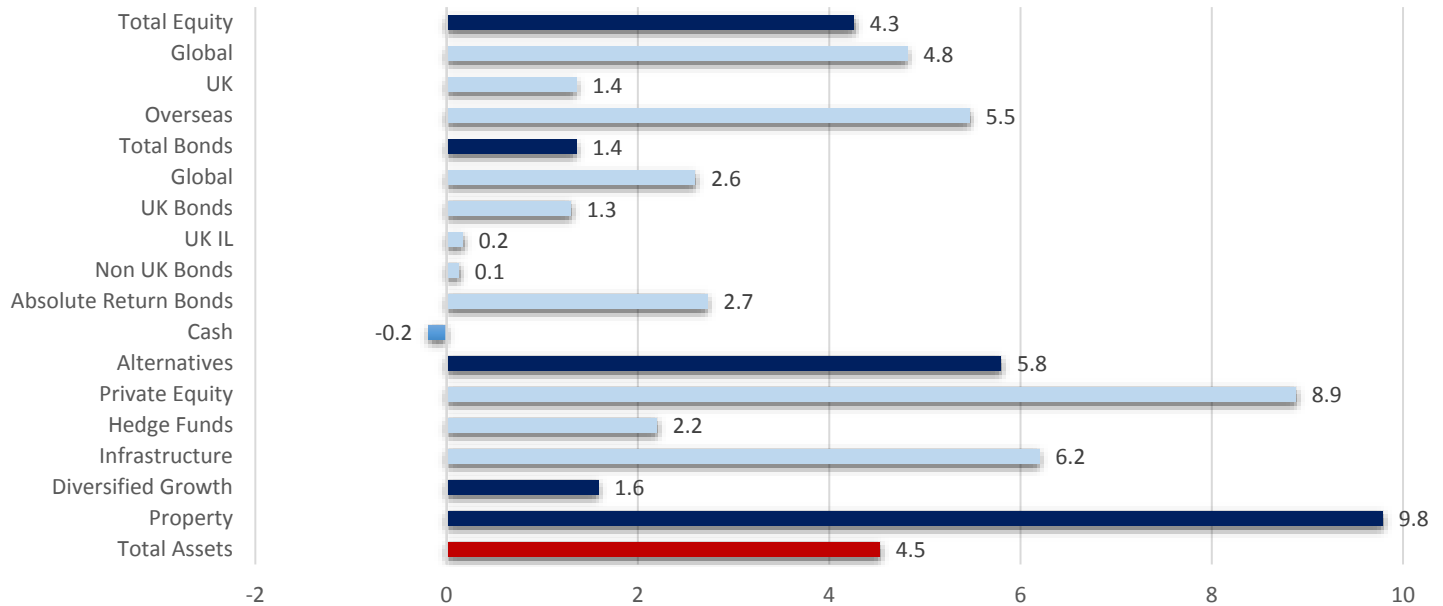
LIST OF APPENDICES:

Appendix 1: LBHF Pension Fund Performance Summary 2017/18

Hammersmith & Fulham Pension Fund Performance Summary For Periods to End March 2018

Universe Overview - Latest Year

Latest Year Performance



- Despite a relatively difficult environment for investors the average local authority fund produced a return of 4.5% for the year
- This was below the long term average but the return was ahead of inflation and broadly in line with actuarial assumptions.
- Asset returns were tightly grouped with bonds, equities and alternatives returning 1%, 4%, and 6% respectively for the year.
- Most funds outperformed their benchmarks by a small margin.

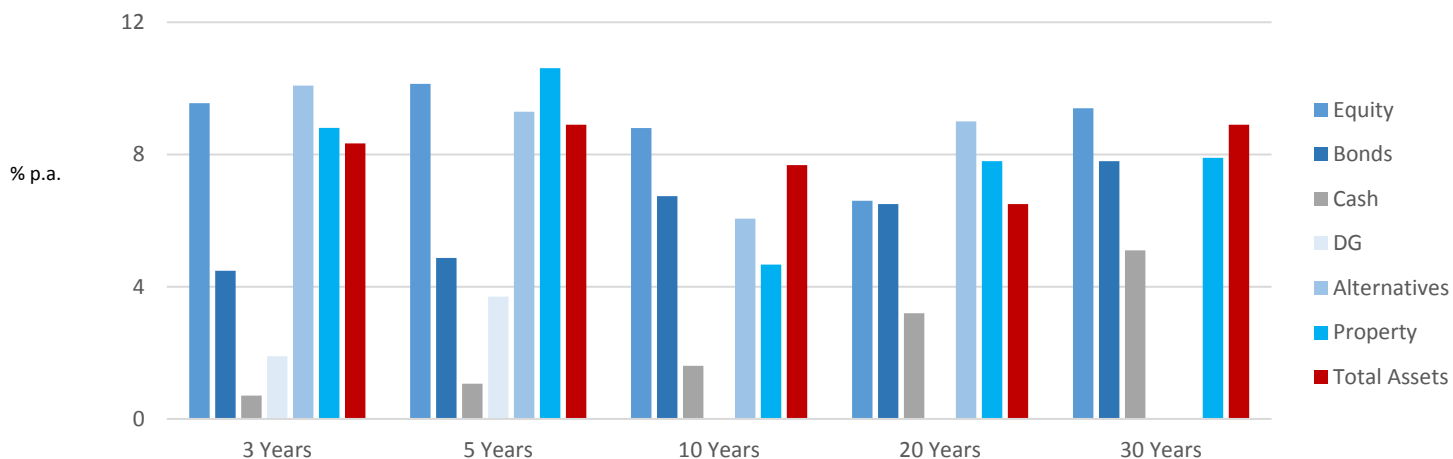
Asset Allocation

- Funds saw the largest reduction in equity exposure since the LGPS began as funds continued the move to less 'risky' assets.
- There was also a focus on income generating assets as many funds are now faced with the possibility of negative cash flow.

% Allocation	End March		
	2017	2018	Change
Equities	62	55	-7
UK	20	15	-5
Overseas	42	40	-2
Bonds	15	18	3
UK	8	8	-
Global	3	4	1
Overseas	1	1	-
Absolute Return	3	5	2
Cash	2	3	1
Alternatives	10	11	1
Private Equity	5	5	-
Infrastructure	2	3	1
Hedge Funds	3	3	-
Diversified Growth (DG)	3	4	1
Property	8	9	1

Universe Longer Term Results

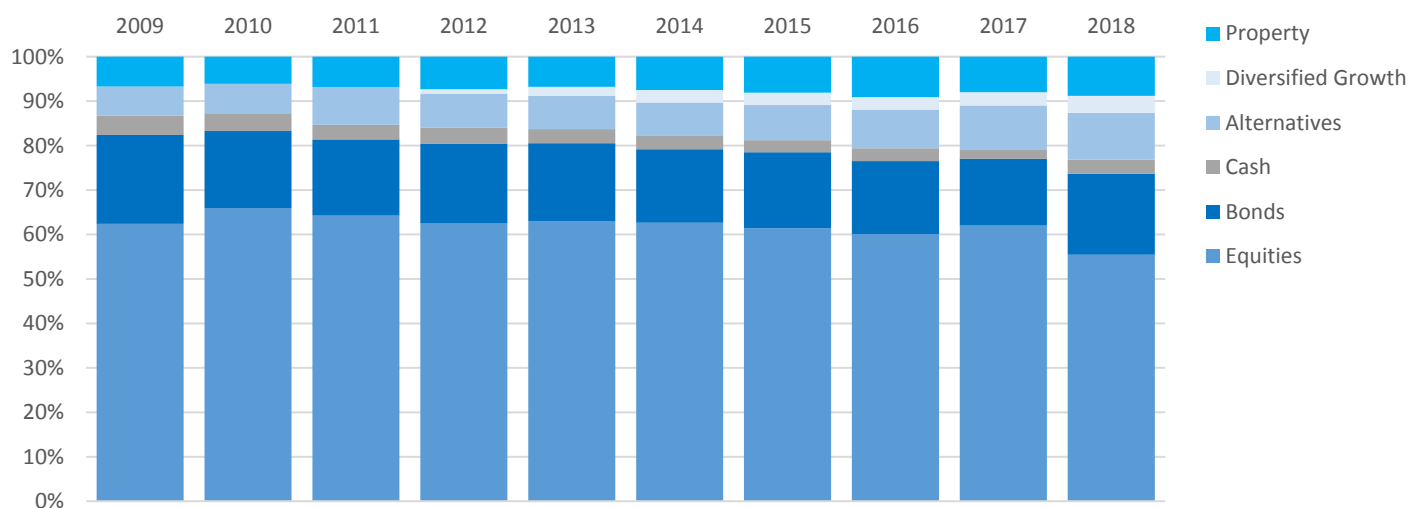
- Long term performance of the LGPS has been excellent. The average funds delivered a positive return in 25 of the last 30 years and delivered an annualised performance of 9% p.a.
- Equities have driven the strong long term performance.
- Alternatives have performed strongly due in a large part to the good returns from private equity.
- Bonds have performed well over the longer term assisted by 'quantitative easing' and strong demand from pension funds.



Equity	9.6	10.1	8.8	6.6	9.4
Bonds	4.5	4.9	6.7	6.5	7.8
Cash	0.7	1.1	1.6	3.2	5.1
Alternatives	10.1	9.3	6.1	9.0	-
DG	1.9	3.7	-	-	-
Property	8.8	10.6	4.7	7.8	7.9
Total Assets	8.3	8.9	7.7	6.5	8.9

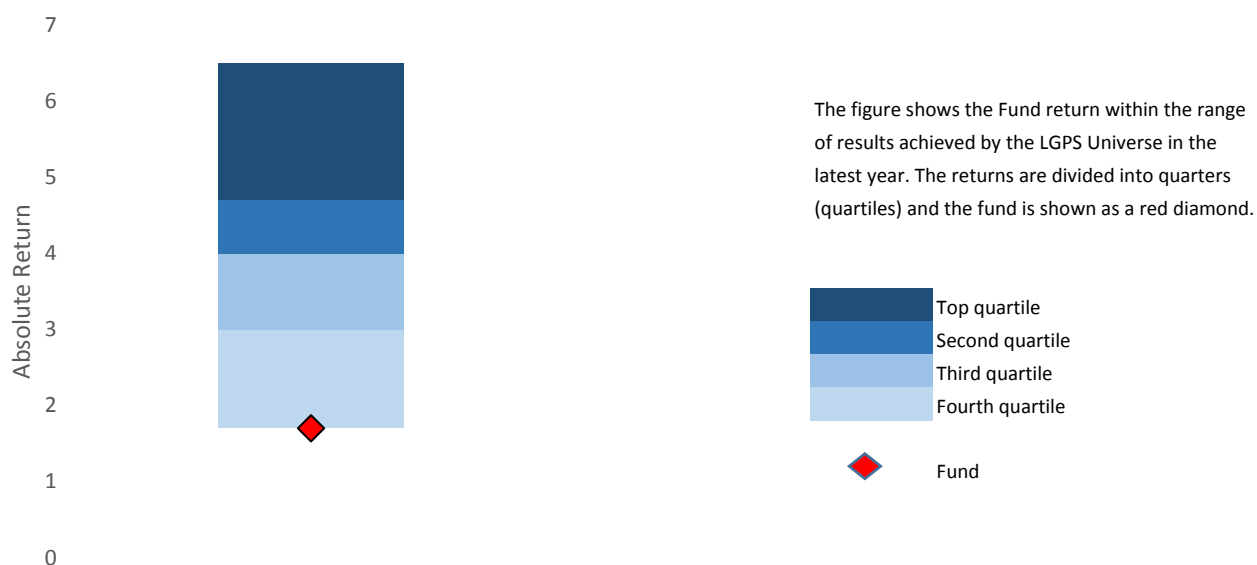
Asset Allocation

- Equities remain the largest allocation within most fund's assets. Three quarters of this allocation is now invested overseas.
- Alternatives have increased markedly over the decade. Private equity makes up a half of this allocation with infrastructure increasing in recent years and expected to increase further.
- Within the bond allocation, there has been a marked move from index based towards absolute return mandates.



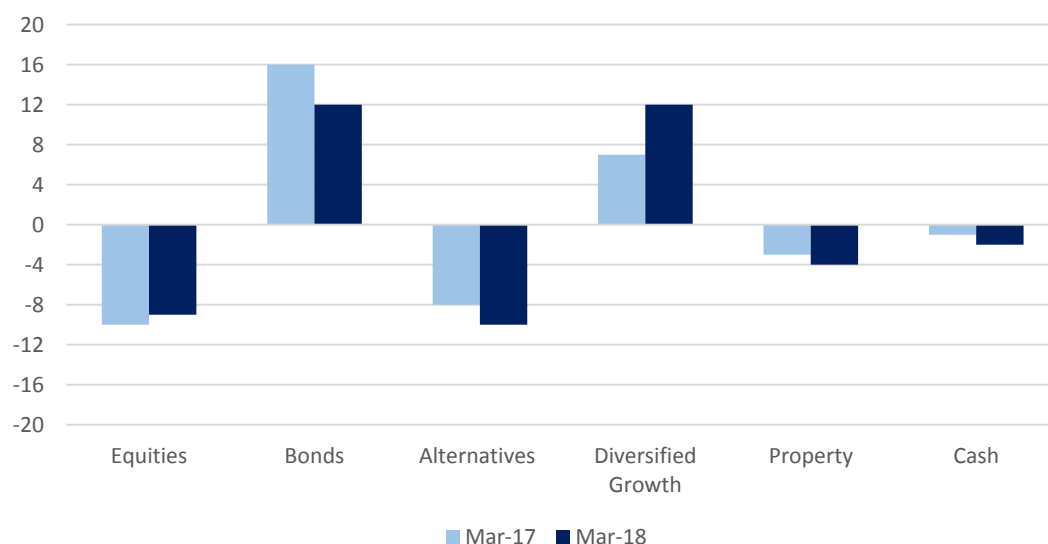
Fund Performance - Latest Year

- The Fund return of 1.7% was below the average and ranked in the 95th percentile.
- Equity selection, where the Fund ranked 97th percentile had a large drag on the relative performance.
- Asset allocation was also detrimental as can be seen below.



Fund Asset Allocation

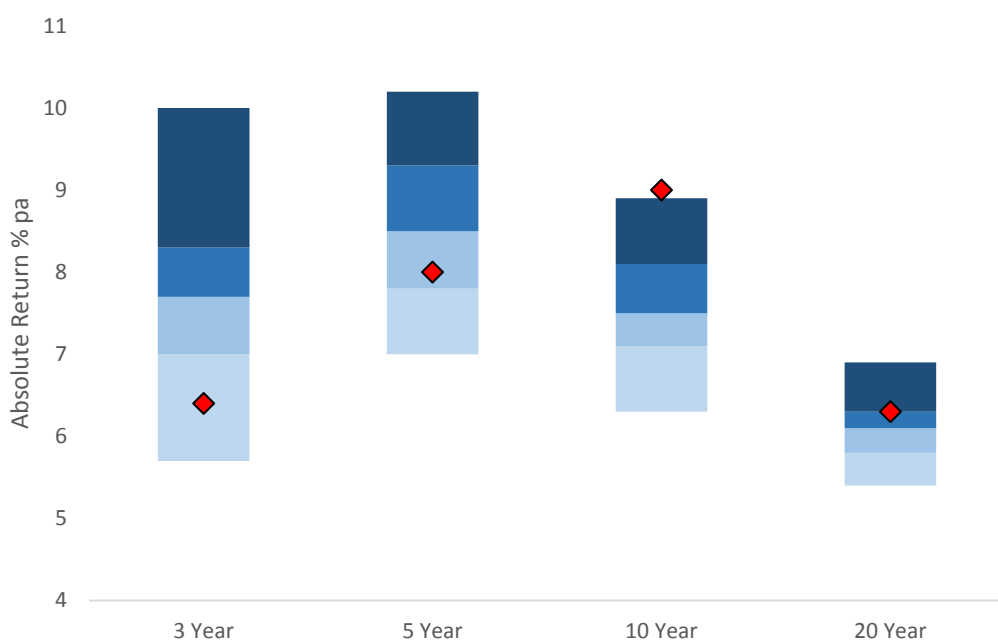
- The Fund is structured quite differently from the average fund.
- The Fund has a significantly lower equity allocation and a much higher bond allocation.
- Over the latest year this structure had a negative impact on the result relative to other funds.



The chart shows the Fund's relative % weightings at asset class level at 31st March 2017 and 2018.

Fund Longer Term Returns

- Performance has been below the average over the near term largely as a result of the Fund's relatively low equity exposure.
- Over the ten year period the result remains extremely good.
- Over all periods the Fund has outperformed both inflation and actuarial assumptions.

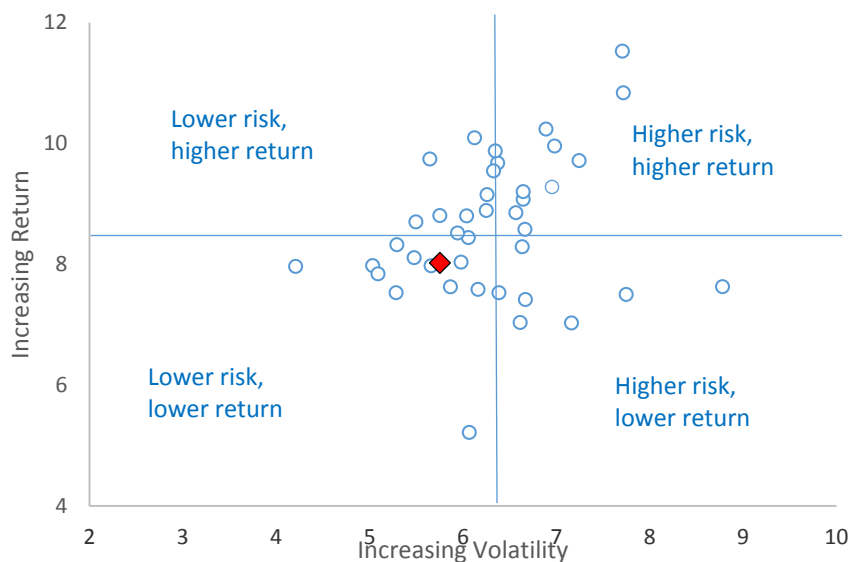


Fund	6.4	8.0	9.0	6.3
Universe Average	8.3	8.8	7.7	6.5
Ranking	(92)	(65)	(4)	(35)

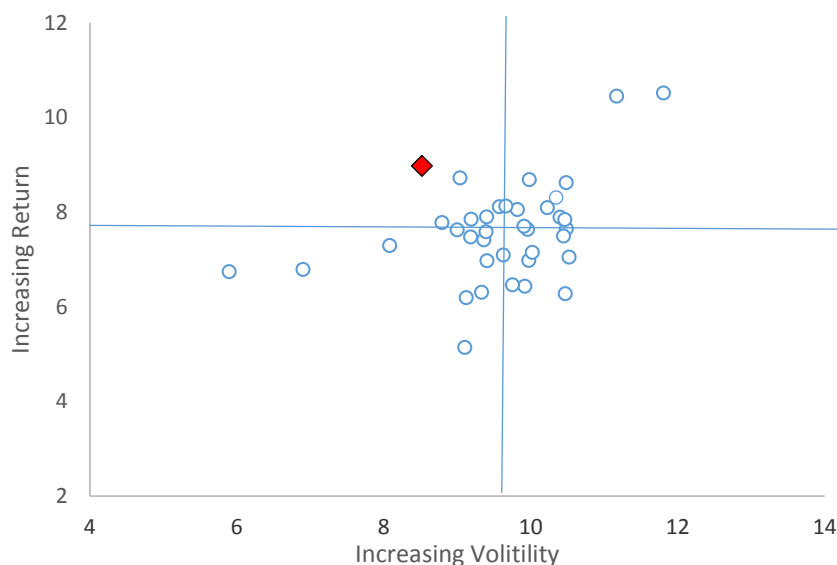
Risk and Return

- Funds have typically been rewarded for additional volatility i.e. higher exposure to equity - more so nearer-term
- Over ten years, the Fund delivered a much higher than average return at a relatively low level of volatility (the optimal combination).
- Over the latest five years, the Fund volatility has remained lower than average but the relative return has reduced.

Last Five Years (% p.a.)




Last Ten Years (% p.a.)



The charts show the funds (blue rimmed dots) in the LGPS Universe in risk/return space. The further up the vertical axis a fund is the better the return achieved. The further along the horizontal axis the more risk has been taken.

The blue lines are the median results. These divide the funds into quadrants. Most funds would prefer to be in the top left quadrant.

Agenda Item 12

London Borough of Hammersmith & Fulham PENSIONS BOARD 6 February 2019		 hammersmith & fulham
PENSION FUND QUARTERLY UPDATE PACK		
Report of the Strategic Director of Finance & Governance		
Open Report		
Classification: For Information		
Key Decision: No		
Wards Affected: None		
Accountable Director: Phil Triggs, Director of Pensions and Treasury		
Report Authors: Tim Mpofu, Pension Fund Manager		Contact Details: Tel: 0207 641 6308 E-mail: tmpofu@westminster.gov.uk

1. Executive Summary

- 1.1. This paper provides the Pensions Board Members with a summary of the Pension Fund's:
 - a. Overall performance for the quarter ended 30 September 2018.
 - b. Cashflow update and forecast.
 - c. Assessment of risks and actions taken to mitigate these.
 - d. Sub-Committee's strategic forward plan.

2. Recommendations

- 2.1. The Pensions Board is recommended to note this report.

3. LBHF Pension Fund Quarter 2 Update

- 3.1. This report and associated appendices make up the pack for the quarter ended 30 September 2018. An overview of the Pension Fund's performance is provided in Appendix 1. This includes administrative, investment, and cash management performance for the quarter.

- 3.2. Appendix 2 provides information about the Pension Fund's investments and performance. Kevin Humpherson from Deloitte will be attending the meeting to present this report.
- 3.3. The actual cashflow for the period July to September 2018 and the forecast up to June 2019 are shown in Appendix 3. An analysis of the differences between the actuals and the forecast for the quarter is also shown.
- 3.4. Appendix 4 shows the Pension Fund's Risk Register which was revamped to show a more meaningful assessment of risks and the actions taken to mitigate them. This has led to the identification of additional risks in investment, governance and administrative areas.
- 3.5. A summary of the voting undertaken by the investment managers running segregated equity portfolios forms Appendix 5. This now includes both the London CIV Majedie and Ruffer portfolios, in addition to the LGIM Global data.
- 3.6. Appendix 6 gives an update on the Forward Plan as at 30 June 2018.
- 3.7. Following the Pensions Sub-Committee meeting held on 4 September 2018, the Pension Fund completed the sale of assets remaining in the residual Majedie Focus and Tortoise Funds on 31 October 2018. These holdings were incorporated into the fund's passive equities transition to the MSCI Low Carbon Index Fund under the LGIM mandate. This transition was completed on 18 December 2018.

4. OPTIONS AND ANALYSIS OF OPTIONS

- 4.1. Not applicable.

5. CONSULTATION

- 5.1. Not applicable.

6. EQUALITY IMPLICATIONS

- 6.1. Not applicable.

7. LEGAL IMPLICATIONS

- 7.1. None.

8. FINANCIAL IMPLICATIONS

- 8.1. None.

9. IMPLICATIONS FOR BUSINESS

9.1. None.

10. BACKGROUND PAPERS USED IN PREPARING THIS REPORT

10.1. None

LIST OF APPENDICES:

Appendix 1: Scorecard at 30 September 2018

Appendix 2: Deloitte quarterly report for quarter ended 30 September 2018

Appendix 3: Cashflow monitoring

Appendix 4: Pension Fund Risk Register

Appendix 5: Pension Fund Voting Summary

Appendix 6: Pensions Sub-Committee Forward Plan

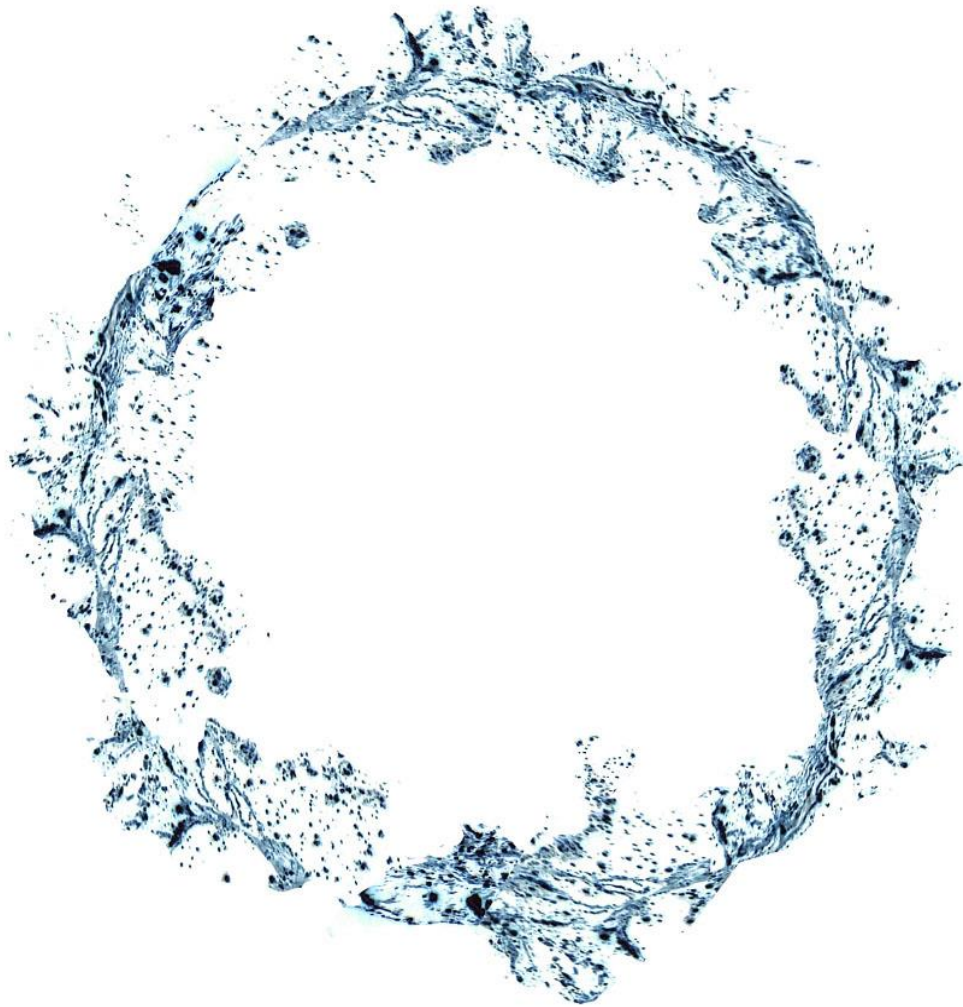
Appendix 1: Scorecard at 30 September 2018

HAMMERSMITH AND FULHAM PENSION FUND QUARTERLY MONITORING

	Dec 17	Mar 18	Jun 18	Sep 18	Comment/ Report Ref if applicable
Value (£m)	1,033.1	997.6	1,035.3	1,055.6	Deloitte Report Gross of Fees
% return quarter	2.6%	-2.5%	4.1%	1.6%	
% return one year	7.1%	1.7%	5.2%	5.8%	
LIABILITIES					
Value (£m)	1,084.9	1,073.6	1,087.4	1,087.4*	
Deficit (£m)	64.8	52.0	42.5	42.5	
Funding Level	94%	95%	96%	96%	
MEMBERSHIP					
Active members	4,228	4,166	4,307	4,306	
Deferred beneficiaries	5,687	6,603	5,752	5,703	
Pensioners	4,909	4,920	4,986	5,018	
Employers	41	41	61	61	
CASHFLOW					
Cash balance	£1.3m	£4.3m	£6.6m	£4.1m	Appendix 3
Variance from forecast	(0.5m)	0.6m	0.6m	0.4m	
RISK					
No. of new risks	0	0	0	39**	Appendix 4 – New Risk Register
No. of ratings changed	0	0	0	0	
VOTING					
No. of resolutions voted on by fund managers	4,732	5,711	5,711	4183	Appendix 5 – LGIM, Ruffer & Majedie this quarter
LGPS REGULATIONS					
New consultations	None	None	None	None	No impact on the pension fund
New sets of regulations	None	None	IFRS9	None	

*To be provided as an additional appendix at the meeting

** The risk register has been revamped to provide a more in depth analysis of risks and mitigating actions being taken. This has led to the inclusion of 39 new risks and a different assessment format.



**London Borough of Hammersmith
& Fulham Pension Fund**

**Investment Performance Report to 30
September 2018**

Deloitte Total Reward and Benefits Limited
November 2018

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1 Market Background

1.1 Three months and twelve months to 30 September 2018

The UK equity market experienced a decline over the third quarter of 2018, as the FTSE All Share Index delivered a return of -0.8% following heightened Brexit uncertainties. The risk of a 'no deal' scenario increased as the deadline for reaching a deal with the EU approaches, and against a wider backdrop of a potential slow-down in global growth. These factors were partly offset by immediate UK employment and wage growth data remaining robust, and the weakening of sterling boosting the value of overseas earnings when converted back into sterling. The FTSE 100 Index fell by 0.7% while the FTSE 250 fell 1.8% over the quarter as smaller more UK-centric companies were more exposed to Brexit related uncertainties. At the sector level, Health Care was the best performing sector returning 4.7%, while Telecommunications was the worst performing sector delivering a negative return of -6.6%.

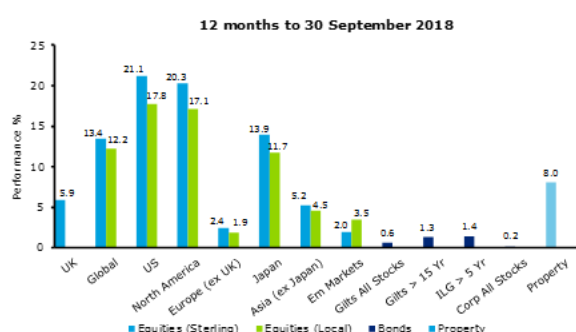
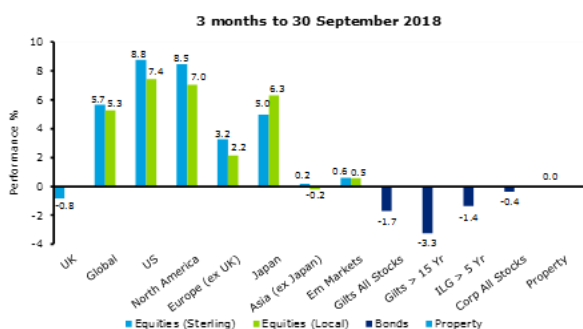
Global equity markets made gains over the third quarter driven by the US, which continued to report strong earnings and economic data, despite a backdrop of geopolitical tensions and escalating trade wars. Global equities outperformed UK equities in both local currency terms (4.8%) and sterling terms (5.7%). The weakening of sterling over the quarter amid continued uncertainties over Brexit meant that currency hedging detracted from returns over the quarter. The US (8.8%) was the best performing region in local terms while the worst performing region – other than the UK – was Asia Pacific ex Japan which delivered a broadly flat return of -0.2%.

Nominal gilt yields increased across the curve as the Bank of England raised the base rate in the UK from 0.5% to 0.75%, and the All Stocks Gilts Index subsequently delivered a return of -1.7% over the quarter. Real yields fell at the very short end but increased for mid- and longer-dated maturities. The overall increase led to the Over 5 Year Index-Linked Gilts Index to deliver a negative return of -1.4% over the period. Credit spreads narrowed over the third quarter, and the iBoxx All Stocks Non Gilt Index subsequently outperformed the gilt indices, falling by 0.4%.

Over the 12 months to 30 September 2018, the FTSE All Share delivered a positive return of 5.9%, which was due to a combination of gains made from the overall improving global economic environment over the year and sterling weakness boosting the value of overseas earnings. There was a wide dispersion of returns at the sector level over the 12-month period. Oil & Gas (19.4%) was the best performing sector as oil prices significantly increased over the period, while Telecommunications (-21.1%) was the poorest performing sector. Global equity markets delivered higher returns than UK markets in both local (11.6%) and sterling terms (13.4%) as overseas markets outperformed the UK, representative of the relatively stronger economic environment overseas in the absence of Brexit related uncertainty.

UK nominal gilts delivered positive returns over the 12 months to 30 September 2018 as yields fell for most middling durations, which was partly offset by an increase at the short-end of the curve. The All Stocks Gilts Index returned 0.6% and the Over 15 Year Gilts Index returned 1.3%. UK index-linked gilts also delivered positive returns, with the Over 5 Year Index-Linked Gilts Index returning 1.4%. Credit spreads widened over the year to 30 September 2018 and corporate bonds underperformed gilts over the year, delivering a broadly flat return of 0.2%.

The IPD UK Monthly Property Index returned 2.2% over the quarter to 30 June 2018 and 10.9% over the year to 30 June 2018, following continued strong demand for UK property – and in spite of the continued uncertainty over Brexit.



Note: Property returns are provided over the quarter and year to 30 June 2018.

2 Performance Overview

2.1 Investment Performance to 30 September 2018

Breakdown of Fund Performance by Manager as at 30 Sept 2018		3	1	2 year	3 year	5 year
Fund	Manager	month	year	p.a.	p.a.	p.a.
Equity Mandate						
	Majedie	-3.9	1.4	7.0	8.8	7.4
FTSE All Share		-0.8	5.7	8.7	11.3	7.4
<i>Difference</i>		-3.0	-4.4	-1.7	-2.5	0.0
	LGIM Global Equity	5.7	13.4	14.1	n/a	n/a
FTSE All World		5.7	13.4	14.2	n/a	n/a
<i>Difference</i>		0.0	-0.1	0.0	n/a	n/a
Dynamic Asset Allocation Mandates						
	Ruffer	-1.0	1.1	0.3	4.0	3.9
3 Month Sterling LIBOR + 4% p.a.		1.2	4.6	4.5	4.5	4.5
<i>Difference</i>		-2.2	-3.5	-4.2	-0.5	-0.6
	Insight	-0.2	-2.6	-1.1	-0.3	n/a
3 Month Sterling LIBOR + 2% p.a.		0.7	2.6	2.5	2.5	n/a
<i>Difference</i>		-0.9	-5.2	-3.6	-2.8	n/a
Private Equity						
	Invesco	10.1	25.6	12.1	12.7	18.8
	Unigestion	0.4	4.9	5.5	10.9	7.9
Secure Income						
	Partners Group MAC	1.5	3.6	4.9	5.3	n/a
3 Month Sterling LIBOR + 4% p.a.		1.2	4.6	4.5	4.5	n/a
<i>Difference</i>		0.3	-1.0	0.4	0.8	n/a
	Oak Hill Advisors	1.4	1.1	3.0	4.6	n/a
3 Month Sterling LIBOR + 4% p.a.		1.2	4.6	4.5	4.5	n/a
<i>Difference</i>		0.2	-3.5	-1.5	0.1	n/a
	Partners Group Infra	3.7	3.1	-2.4	1.8	n/a
	Aviva Infra Income	0.7	n/a	n/a	n/a	n/a
Inflation Protection						
	M&G	1.9	5.7	4.2	8.7	n/a
RPI + 2.5% p.a.		1.5	5.8	6.1	5.5	n/a
<i>Difference</i>		0.3	0.0	-1.8	3.2	n/a
	Aberdeen Standard	1.8	8.3	9.2	7.5	n/a
FT British Government All Stocks		-1.2	2.6	0.5	5.0	n/a
<i>Difference</i>		3.0	5.7	8.7	2.5	n/a
Total Fund		1.5	5.3	6.8	9.5	8.5
Benchmark*		2.1	7.5	7.8	9.7	6.2
<i>Difference</i>		-0.6	-2.1	-1.0	-0.2	2.3

Source: Northern Trust (Custodian). Figures are quoted net of fees and estimated by Deloitte. Differences may not tie due to rounding.

(*) The Total Assets benchmark is the weighted average performance of the target asset allocation.

3 Total Fund

3.1 Investment Performance to 30 September 2018

	Last Quarter	One Year	Two Years	Three Years	Five Years
	(%)	(%)	(% p.a.)	(% p.a.)	(% p.a.)
Total Fund – Gross of fees	1.6	5.8	7.3	9.9	9.0
Net of fees ⁽¹⁾	1.5	5.3	6.8	9.5	8.5
Benchmark ⁽²⁾	2.1	7.5	7.8	9.7	6.2
Net performance relative to benchmark	-0.6	-2.1	-1.0	-0.2	2.3

Source: Northern Trust. Relative performance may not sum due to rounding.

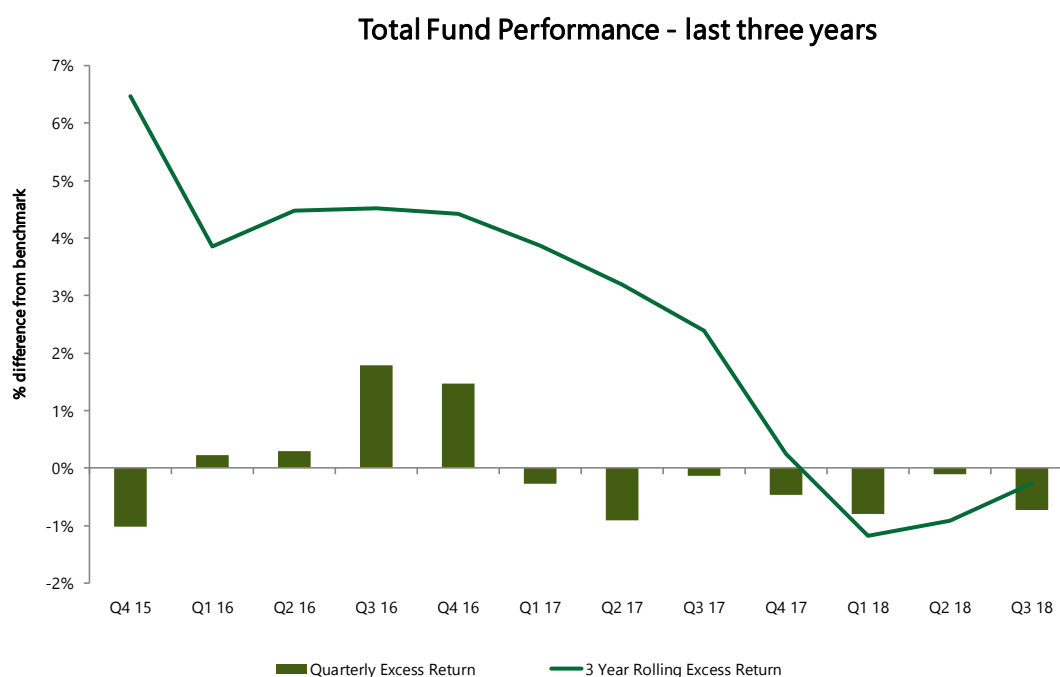
(1) Estimated by Deloitte

(2) Average weighted benchmark

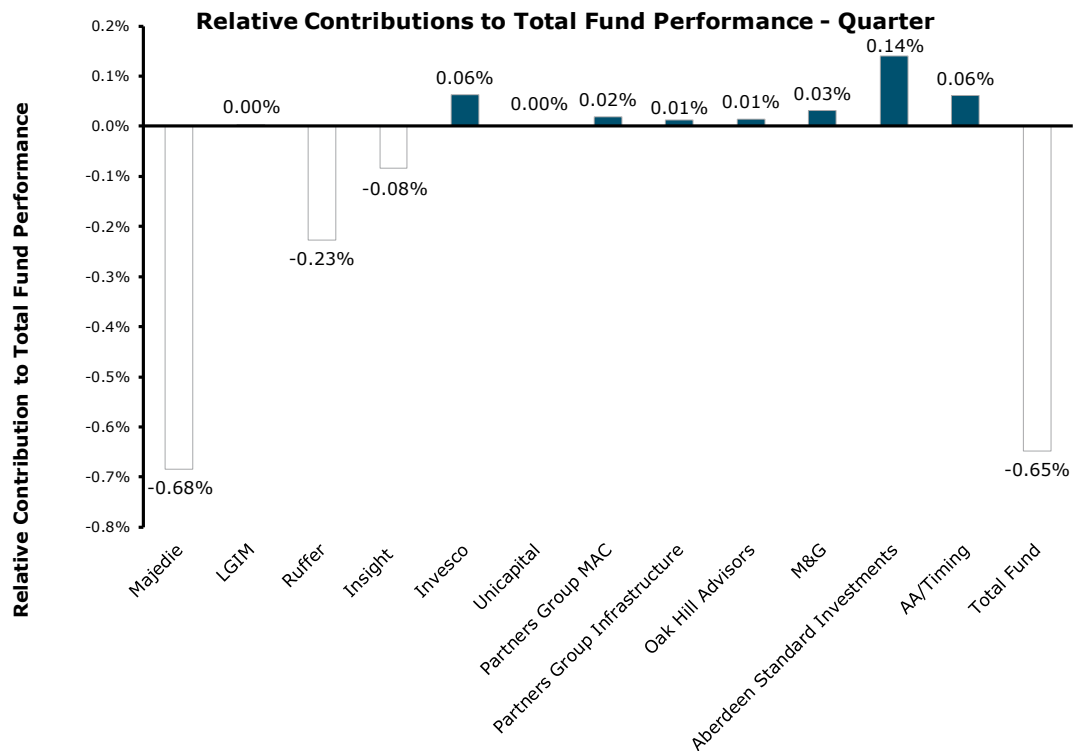
Over the quarter to 30 September 2018, the Total Fund returned 1.5% net of fees, underperforming its fixed weight benchmark by 0.6%.

Over the 12 month period, the Fund delivered a net return of 5.3%, underperforming the benchmark by 2.1%. Over the three year period the Fund underperformed the benchmark by 0.2% p.a. but remains ahead of the benchmark over the five year period by 2.3% p.a.

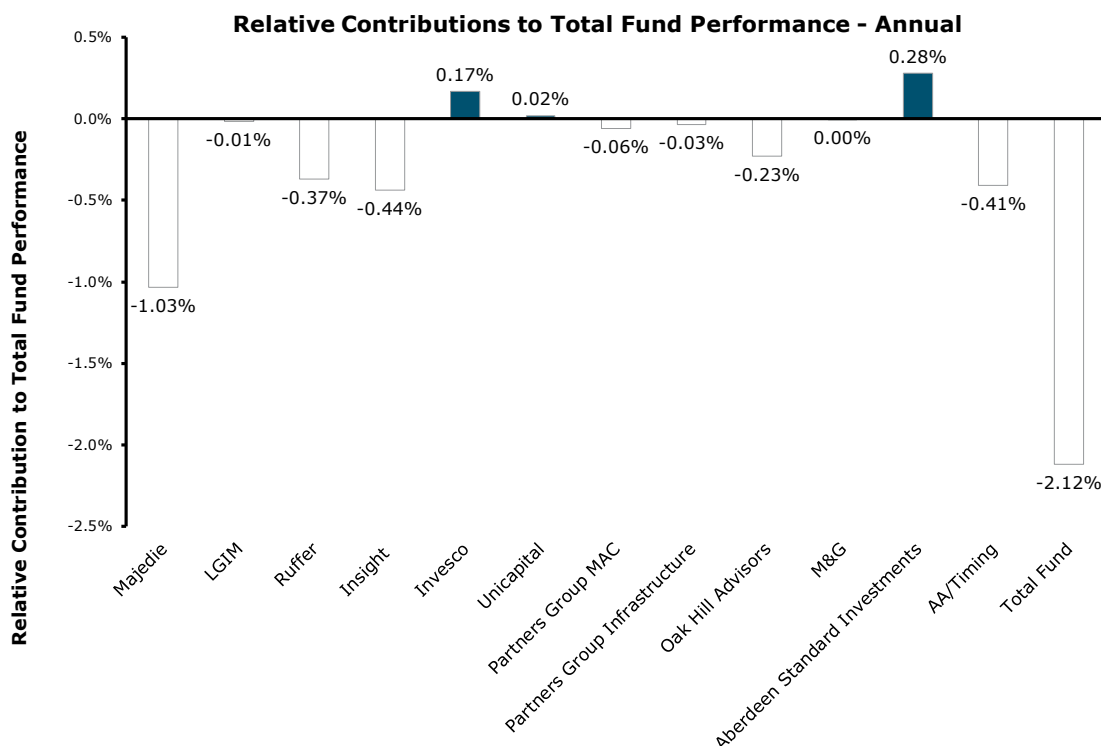
The chart below compares the net performance of the Fund relative to the fixed weight benchmark over the three years to 30 September 2018. The 3 year rolling excess return has been declining over recent quarters. This was to be expected as a result of the strong performance from Majedie towards the end of 2014 and start of 2015 dropping out of the 3 year calculations. The recent underperformance from Majedie and Ruffer has been the main contributor to the declining 3 year rolling excess returns.



3.2 Attribution of Performance to 30 September 2018



The Fund underperformed the composite benchmark by 0.6% on a net of fees basis over the third quarter of 2018, largely as a result of underperformance from Majedie. Ruffer and Insight also detracted from performance over the quarter to 30 September 2018.



Over the year to 30 September 2018 the Fund underperformed the composite benchmark by 2.1%. This was largely as a result of the underperformance from Majedie, along with negative contributions from Insight, Ruffer and Oak Hill Advisors. The negative contribution represented by the "AA/Timing" bar was primarily a function of the Fund having an overweight allocation to equities over the 12 month period to 30 September 2018.

3.3 Asset Allocation

The table below shows the assets held by each manager as at 30 September 2018 alongside the Target Benchmark Allocation.

Manager	Asset Class	Actual Asset Allocation				Benchmark Allocation (%)
		30 June 2018 (£m)	30 Sept 2018 (£m)	30 June 2018 (%)	30 Sept 2018 (%)	
Majedie	UK Equity (Active)	175.5	168.9	16.9	16.0	15.0
LGIM	Global Equity (passive)	323.9	342.3	31.3	32.4	30.0
	Total Equity	499.3	511.2	48.2	48.4	45.0
Ruffer	Absolute Return	132.0	130.9	12.7	12.4	10.0
Insight	Bonds Plus	87.1	87.0	8.4	8.2	10.0
	Total Dynamic Asset Allocation	219.0	217.9	21.2	20.6	20.0
Invesco	Private Equity	4.0	4.4	0.4	0.4	0.0
Unicapital	Private Equity	1.6	1.6	0.2	0.2	0.0
	Total Private Equity	5.6	6.0	0.5	0.6	0.0
Partners Group	Multi Asset Credit	37.6	38.3	3.6	3.6	5.0
Oak Hill Advisors	Diversified Credit Strategy	72.1	73.2	7.0	6.9	7.5
Partners Group	Direct Infrastructure	9.1	13.5	0.9	1.3	5.0
Aviva	Infrastructure Income	28.2	28.2	2.7	2.7	2.5
	Secure Income	147.0	153.2	14.2	14.5	20.0
M&G	Inflation Opportunities	100.4	102.3	9.7	9.7	10.0
Aberdeen Standard Investments	Long Lease Property	53.0	54.0	5.1	5.1	5.0
	Total Inflation Protection	153.4	156.3	14.8	14.8	15.0
LGIM	Liquidity Fund	10.8	10.9	1.0	1.0	0.0
	Total	1,035.3	1,055.6	100.0	100.0	100.0

Source: Northern Trust (Custodian) and have not been independently verified

Figures may not sum to total due to rounding

3.4 Yield Analysis as at 30 September 2018

The following table shows the running yield on the Fund's investments:

Manager	Asset Class	Yield as at 30 September 2018
Majedie	UK Equity	2.90%*
LGIM	Global Equity	0.21%**
Ruffer	Dynamic Asset Allocation	1.20%
Insight	Dynamic Asset Allocation	0.67%
Partners Group MAC	Secure Income	3.65%
Oak Hill Advisors	Secure Income	6.20%
M&G	Inflation Protection	2.60%
Aberdeen Standard Investments	Inflation Protection	4.05%
	Total	1.76%

*Majedie yield provided by the London CIV and is a historic yield, reflecting distributions declared over the past 12 months as a percentage of average market value. Yield as at 30 June 2018.

**Benchmark yield is 2.4% (represents the income that would be generated).

4 Summary of Manager Ratings

The table below summarises Deloitte's ratings of the managers employed by the Fund and triggers against which managers should be reviewed.

Manager	Mandate	Triggers for Review	Rating
Majedie	UK Equity	Further turnover within the core investment team Re-opening the UK equity products with no clear limits on the value of assets that they would take on	1
LGIM	Global Equities	Major deviation from the benchmark return Significant loss of assets under management	1
Ruffer	Absolute Return	Departure of either of the co-portfolio managers from the business Any significant change in ownership structure	1
Insight	Bonds Plus	A significant increase or decrease to the assets under management with no set limits Significant changes to the team managing the Fund	1
Partners Group	Multi Asset Credit	Significant changes to the investment team responsible for the Fund *Note the mandate is subject to a 7 year lock-up period	1
	Direct Infrastructure	Significant changes to the investment team responsible for the Fund. *Note the mandate is subject to a 10 year lock-up period	1
Aviva Investors	Infrastructure Income	Significant changes to the investment team responsible for the Fund	1
Oak Hill Partners	Diversified Credit Strategy	Significant changes to the investment team responsible for the Fund. Significant changes to the liquidity of underlying holdings within the Fund.	1
M&G	Inflation Opportunities	If the Fund's portfolio manager Gary Parker was to leave the business or cease to be actively involved in the Fund, this would trigger a review of the Fund. Failure to find suitable investments within the initial two year funding period.	1
Aberdeen Standard Investments	Long Lease Property	Richard Marshall leaving the business or ceasing to be actively involved in the Fund without having gone through an appropriate hand-over. A build up within the Fund of holdings with remaining lease lengths around 10 years.	1

4.1 London CIV

Business

As at 30 September 2018, the London CIV had 12 sub-funds and assets under management of £7.6bn. The total assets under oversight (which includes passive investments held outside of the CIV platform) increased over the quarter from c. £16.2bn to c. £17.3bn and represents c. 47% of the 32 London Borough's total AuM.

Personnel

The LCIV hired two new investment analysts over the quarter (Umer Nazir and Pruthvi Odedra) as well as welcoming back Maggie Abrahams as Deputy Chief Operating Officer. Will McBean also joined the client team over the quarter.

Deloitte view – It is crucial that steps are taken to rebuild the senior management team and an appropriate strategy agreed for taking the pool forward, getting "buy-in" from the shareholders. We are continuing to monitor developments on the business side as well as the new fund launches.

4.2 Majedie

Business

The total assets under management for Majedie was c. £14.1bn as at 30 September 2018, a decrease of c. £0.9bn over the third quarter of 2018.

Personnel

There were no significant team or personnel changes over the quarter to 30 September 2018.

Deloitte view – We continue to rate Majedie positively for its UK Equity capabilities.

4.3 LGIM

Business

As at 30 June 2018, Legal & General Investment Management ("Legal & General") had total assets under management ("AuM") of £985bn, an increase of £2bn since 31 December 2017.

Personnel

At a firm level, LGIM announced in July that Mark Zinkula, CEO of LGIM (UK), would be retiring on 31 August 2019. The announcement had been expected to an extent, as Mark had always made clear his period based in the UK would be finite and that he planned to return to the US. The 13-month notice period is expected to give LGIM sufficient time to appoint a replacement and ensure a smooth transition.

In August, LGIM announced that Siobhan Boylan, Chief Financial Officer, would be leaving at the end of the year. In October, LGIM announced that Richard Lee would be taking on the CFO role from November. Richard, currently Group Performance Director, was previously CFO and Chief Risk Officer for Legal & General Retirement.

At the Index team level, there were no new joiners but one leaver over the third quarter of 2018, as Harvey Sidhu left his role as Head of Index Plus.

At the LDI team level, LGIM announced that Simon Wilkinson, Head of Solutions Portfolio Management, will be leaving the firm to pursue other interests. Guy Whitby-Smith, previously Co-Head of LDI Portfolio Construction, was promoted to replace Simon as Head of Solutions Portfolio Manager with effect from October 2018. Guy has worked closely with Simon and has played a leading role in his previous position in evolving LGIM's business beyond traditional LDI strategies into a wider range of holistic risk management solutions. LGIM have confirmed they will shortly be announcing two further senior appointments in the investment team.

During the third quarter of 2018, there were two new joiners to the LDI team and three leavers. Two new solutions portfolio managers – Fiona Wu and Camille Paret – were hired, while Jeremy Rideau (Portfolio Solutions Pooled Fund Manager), Azeem Malik (Quantitative Modelling Analyst) and Natalie Stimpson (Solutions Strategist) left their respective roles.

Deloitte View

We continue to rate Legal & General positively for its passive and LDI capabilities. We feel the changes to the LDI team, particularly the departure of Simon Wilkinson, are significant given Simon's status. While we do not have any major concerns at this stage, we will continue to monitor updates of LGIM's succession plan.

4.4 Ruffer

Business

Total assets under management was £21.8bn as at 30 September 2018, a decrease from £22.3bn at 30 June 2018. Pension fund client pitches and new mandates continued to grow over the quarter. Outflows were mainly from partial de-risking by existing clients.

Personnel

There were no significant team or personnel changes over the third quarter of 2018.

Deloitte view – The Ruffer product is distinctive within the universe of diversified growth managers with the manager willing to take contrarian, long term positions, where necessary drawing on the expertise of external funds.

4.5 Insight

Business

Insight's total AuM remained broadly unchanged over the quarter, with over £600bn in assets under management, as at 30 September 2018. Total assets in Insight's Bonds Plus Fund was £4.2bn as at 30 September 2018, an increase of c. £0.1bn over the quarter.

Personnel

Insight made no changes to the Bonds Plus team over the quarter.

Deloitte view – Performance of the Bonds Plus fund has been disappointing. We are currently conducting a review of the product.

4.6 Partners Group

Business - Multi Asset Credit

The net asset value of the MAC Fund was c. £159m as at 30 September 2018, a fall of c. £1m from 30 June 2018 following the two distributions made in July and August more than offsetting the positive return in the quarter. The investment period for the 2014 MAC vintage finished at the end of July 2017, and the fund is continuing to make distributions back to investors in 2018.

Business - Direct Infrastructure

Total commitment value as at 30 September 2018 remained at c. €1,080m as the Fund held no further closes over the quarter.

The Fund ended the quarter at c. 30.7% drawn down, with commitment level increasing to 55.6% from 48.3% over the quarter.

Deloitte View – We continue to rate Partners Group for its private market capabilities.

4.7 Oak Hill Advisors – Diversified Credit Strategy (DCS)

Business

The total assets under management were approximately \$32.1bn as at 1 August 2018, a decrease of c. \$0.8bn since 30 June 2018.

The Fund had c. \$125m of net outflows during the quarter.

Personnel

In August, Eric Muller joined the firm as Portfolio Manager and Partner. Eric joined from Goldman Sachs' Merchant Banking Division where he was a partner.

Deloitte view – We are comfortable with how the strategy is being managed and the level of risk within the strategy.

4.8 M&G – Inflation Opportunities Fund

Business

Assets under management in the Inflation Opportunities Fund V Fund as at 30 September 2018 were c. £513m, an increase from c. £506m at the previous quarter end.

Personnel

There were no significant changes to the M&G Inflation Opportunities Fund team over the quarter.

Deloitte view – The strategy has a high allocation to ILGs and has not managed to source as many 'inflation linked opportunities' as originally expected given the change in market conditions. The manager expects to increase the allocation to long lease property and, while we are positive on this asset class, it does create overlap with the Fund's Long Lease Property mandate with Standard Life Investments. As such, the Committee may wish to consider whether there are alternative options that could be considered for all or part of the allocation in this strategy which offer at least a degree of "inflation proofing".

4.9 Aberdeen Standard Investments – Long Lease Property

Business

The Fund's assets under management increased by £0.1bn to c. £2.3bn as at 30 September 2018.

Personnel

There were no team changes for either the Long Lease Property Fund or Ground Rent Fund over the third quarter.

Process

Since the two businesses merged, ASI has put in place a formalised process where all potential transactions are reviewed and an "allocation policy" applied where interest is expressed in the investment by more than one fund/client portfolio.

Deloitte View – We remain positive on long lease property given the long-term, inflation-linked nature of the contractual cashflows which arise from this type of investment.

4.10 Aviva Investors

Business

The Aviva Infrastructure Income Fund had a total subscription value of £1,235m as at 30 September 2018. No investor commitments were received over the third quarter, although the Fund has two investors who have elected to have distributions re-invested. The undrawn amount as at 30 September was £287.2m.

Personnel

Two associates and two analysts were added to the team over the quarter to 30 September 2018, with the aim of providing added resource for the senior team members to assess new opportunities.

Deloitte View - We continue to rate Aviva Investors positively for its infrastructure capabilities.

5 London CIV

5.1 Investment Performance to 30 September 2018

As at 30 September 2018, the London CIV had 12 sub-funds and assets under management of £7,572m. The total assets under oversight (which includes passive investments held outside of the CIV platform) increased over the quarter from c. £16.2bn to £17.3bn.

The table below provides an overview of the sub-funds currently available on the London CIV platform.

Sub-fund	Asset Class	Manager	Total AuM as at 30 June 2018 (£m)	Total AuM as at 30 September 2018 (£m)	Number of London CIV clients	Inception Date
LCIV MJ UK Equity	UK Equity	Majedie	546	526	3	18/05/17
LCIV Global Equity Alpha	Global Equity	Allianz Global Investors	114	120	1	02/12/15
LCIV BG Global Alpha Growth	Global Equity	Baillie Gifford	2,183	2,371	12	11/04/16
LCIV NW Global Equity	Global Equity	Newton	575	616	3	22/05/17
LCIV LV Global Equity	Global Equity	Longview Partners	516	683	4	17/07/17
LCIV EP Income Equity	Global Equity	Epoch Investment Partners	225	235	2	08/11/17
LCIV HN Emerging Market Equity	Global Equity	Henderson Global Investors	105	186	3	11/01/18
LCIV RBC Sustainable Equity Fund	Global Equity	RBC Global Asset Management (UK)	269	283	2	18/04/18
LCIV PY Total Return	Diversified growth fund	Pyrford	312	315	5	17/06/16
LCIV Diversified Growth	Diversified growth fund	Baillie Gifford	507	637	8	15/02/16
LCIV RF Absolute Return	Diversified growth fund	Ruffer	902	912	10	21/06/16
LCIV NW Real Return	Diversified growth fund	Newton	338	194	2	16/12/16
LCIV MAC Fund	Multi Asset Credit	CQS	343	492	6	31/5/18
Total			6,937	7,572		

Over the quarter, the NW Real Return sub fund (managed by Newton) lost one London Boroughs from its client list. Whereas the MAC sub fund (managed by CQS) added two new London Boroughs to its client list and each of the Global Alpha Growth (managed by Baillie Gifford), Global Equity (managed by Longview Partners), Emerging Market Equity (managed by Henderson Global Investors) and Diversified Growth (managed by Baillie Gifford) sub funds each added another London Borough to their client list.

6 Majedie – UK Equity

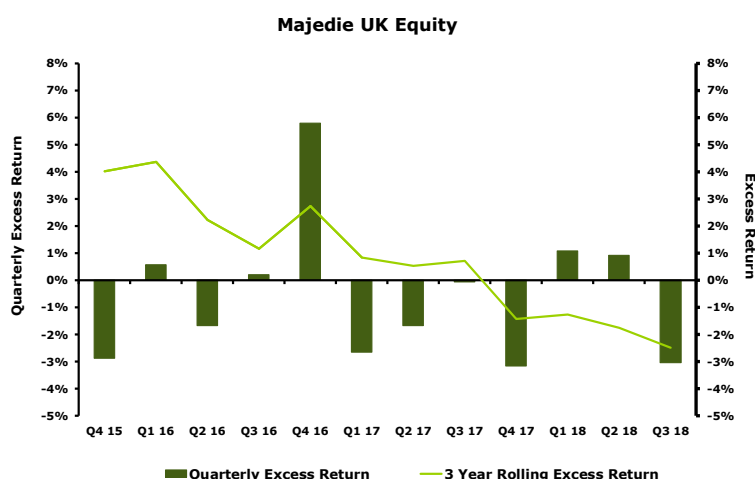
Majedie was appointed to manage an actively managed segregated UK equity portfolio. The manager's remuneration is a combination of a tiered fixed fee, based on the value of assets and a performance related fee of 20% of the outperformance which is payable when the excess return over the FTSE All Share +2% p.a. target benchmark over a rolling three year period. The investment with Majedie comprises a combination of the UK Equity Fund (no more than 30%), the UK Focus Fund and a holding in Majedie's long/short equity fund, Tortoise (no more than 10%).

6.1 UK Equity – Investment Performance to 30 September 2018

	Last Quarter (%)	One Year (%)	Two Years (% p.a.) ⁽¹⁾	Three Years (% p.a.)	Five Years (% p.a.)
Majedie – Gross of fees	-3.7	2.0	7.6	9.3	7.9
Net of fees ⁽¹⁾	-3.9	1.4	7.0	8.8	7.4
Benchmark	-0.8	5.7	8.7	11.3	7.4
Target	0.3	7.7	10.7	13.3	9.4
Net performance relative to Benchmark	-3.0	-4.4	-1.7	-2.5	0.0

Source: Northern Trust

(1) Estimated by Deloitte



The strategy delivered a negative return of -3.9% on a net of fees basis over the quarter against a benchmark return of -0.8%. This took the annual performance net of fees to 1.4% versus a benchmark return of 5.7%. The strategy is lagging the benchmark return by 2.5% p.a. over the three year period to 30 September 2018. Although over the five year period to 30 September 2018, the strategy successfully tracked its FTSE based benchmark return on a net of fees basis, but remained 2% p.a. below the target.

6.2 Performance Analysis

The top 10 holdings in the UK Equity strategy account for c. 49.7% of the Fund and are detailed below.

Top 10 holdings as at 30 September 2018	Proportion of Majedie Fund
Majedie Asset Management Special	8.7%
BP	8.2%
Royal Dutch Shell	8.2%
Tesco	5.4%
GlaxoSmithKline	4.2%
WM Morrison	3.6%
HSBC	3.4%
Centrica	3.0%
Orange	2.8%
Vodafone	2.2%
Total	49.7%

Note: The numbers in this table may not sum due to rounding.

Source: London CIV.

The tables below shows the top 5 and bottom 5 contributors to performance over the quarter to 30 September 2018.

Top 5 contributors as at 30 September 2018	Contribution (bps)
BP	+0.27
WM Morrison	+0.14
BT	+0.14
Ensco	+0.14
JLT	+0.14

Top 5 detractors as at 30 September 2018	Contribution (bps)
Majedie Asset Management Special	-0.45
Tesco	-0.36
Vodafone	-0.26
Ryanair	-0.25
Kaz Minerals	-0.23

The Fund's holdings in the Majedie Asset Management Special, Tesco plc and Vodafone Group plc provided the biggest detractions to performance over the quarter to 30 September 2018.

7 Legal and General – Global Equity

Legal and General Investment Manager ("LGIM") was appointed to manage a global equity portfolio with the objective of replicating the performance of the FTSE All World Index benchmark. The manager is remunerated on a tiered fixed fee based on the value of assets.

7.1 Global Equity – Investment Performance to 30 September 2018

	Last Quarter (%)	One Year (%)	Two Years (% p.a.)
LGIM – Gross of fees	5.7	13.4	14.2
Net of fees ⁽¹⁾	5.7	13.4	14.1
Benchmark	5.7	13.4	14.2
Net Performance relative to Benchmark	0.0	-0.1	0.0

Source: LGIM. Relative performance may not tie due to rounding.

(1) Estimated by Deloitte

On a net of fees basis, the Fund provided returns in line with benchmark over the quarter and two years p.a. periods to 30 September 2018, delivering returns slightly behind its benchmark over the year.

8 Ruffer – Absolute Return

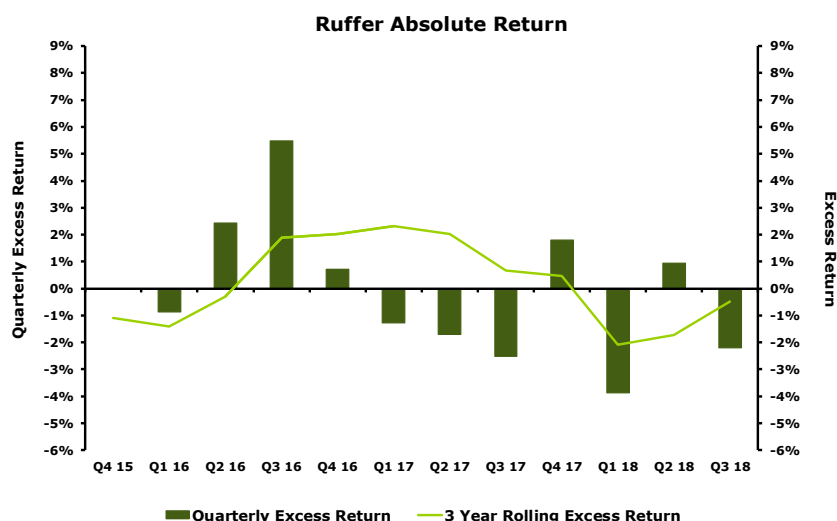
Ruffer was appointed to manage an absolute return mandate with the aim of outperforming the 3 month Sterling LIBOR benchmark by 4% p.a. The manager has a fixed fee based on the value of assets.

8.1 Dynamic Asset Allocation – Investment Performance to 30 September 2018

	Last Quarter (%)	One Year (%)	Two Years (% p.a.) ⁽¹⁾	Three Years (% p.a.)	Five Years (% p.a.)
Ruffer - Gross of fees	-0.8	1.9	1.1	4.8	4.8
Net of fees ⁽¹⁾	-1.0	1.1	0.3	4.0	3.9
Benchmark / Target	1.2	4.6	4.5	4.5	4.5
Net performance relative to Benchmark	-2.2	-3.5	-4.2	-0.5	-0.6

Source: Northern Trust. Relative performance may not tie due to rounding.

(1) Estimated by Deloitte



Ruffer underperformed its Libor +4% p.a. target over the third quarter of 2018 by 2.2% net of fees. This takes the 12 month and three year absolute net performance to 1.1% and 4.0% p.a. respectively.

With parts of the commodity complex pressured with a decline in copper price and the index of gold mining shares falling, the portfolio took advantage by raising its exposure to gold miners. Rising US interest rates and further strength in the US dollar negatively impacted the gold and gold equities sector. This led to steep falls in the portfolio's gold mining shares.

Over the 12 month period to 30 September 2018, the Fund underperformed its target by 3.5%. This is largely due to the Fund's relatively unchanged defensive position over the previous 12 months. Much of the drag has come from the portfolio's VIX positions, with very little volatility in the market recently. With volatility subsiding and global equity markets strengthening towards the end of the 12 month period, the protection assets in the portfolio, particularly option protection, have been a deterrent to performance over the longer term.

9 Insight – Bonds Plus

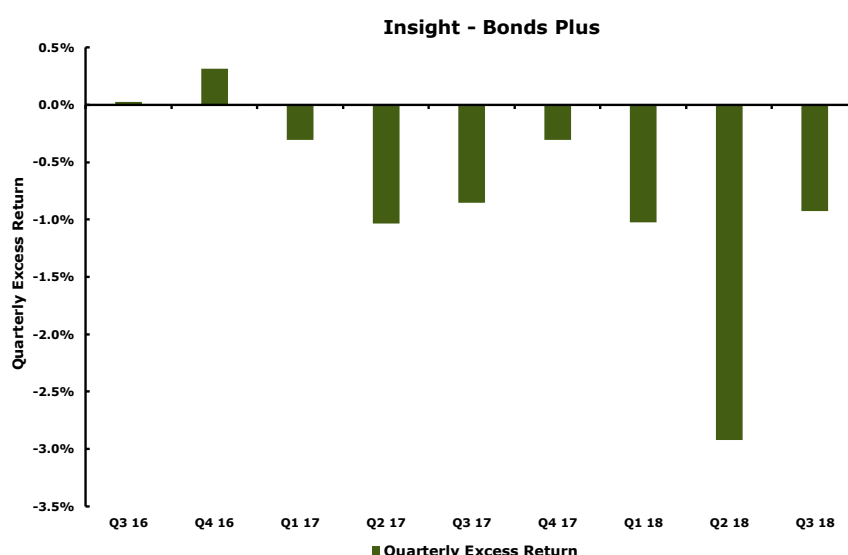
Insight was appointed to manage an active bond portfolio with an aim of outperforming the 3 Month Sterling LIBOR by 2% over a rolling three year period. The fees are based on the value of assets invested in the fund.

9.1 Absolute Return – Investment Performance to 30 September 2018

	Last Quarter (%)	One Year (%)	Two Years (% p.a.)	Three Years (% p.a.)
Insight - Gross of fees	-0.1	-2.1	-0.6	0.2
Net of fees ⁽¹⁾	-0.2	-2.6	-1.1	-0.3
Benchmark / Target	0.7	2.6	2.5	2.5
Net performance relative to Benchmark	-0.9	-5.2	-3.6	-2.8

Source: Northern Trust. Relative performance may not tie due to rounding

(1) Estimated by Deloitte



Insight underperformed its target over the third quarter by 0.9% net of fees.

The Fund's long duration positions were negative over the quarter, with a tactical US yield curve flattener (short 2 year versus long 10 year) detracting from performance as the yield curve steepened.

Investment grade credit also provided a small negative due to short holdings in CDS to off-set long holdings in investment grade and high yield cash bonds. Emerging market debt exposure and currency also detracted from performance over the quarter, driven by the sell-off of emerging market debt and the USD versus emerging market currencies respectively.

The Bonds Plus Fund has delivered disappointing returns since inception. Following a meeting with Insight, we understand that the key detractors from performance have come from a number of the fund's strategic views on market. In particular, a number of the longer term country allocation views that was deemed attractive (when trades were initially put on) have moved against them under the current geopolitical environment. Despite the mark-to-market, the manager continues to believe in the positions they have put on and have not cut their positions. Although performance has been weak the manager continues to adopt the same investment process and are not taking additional risk in order to deliver the target return.

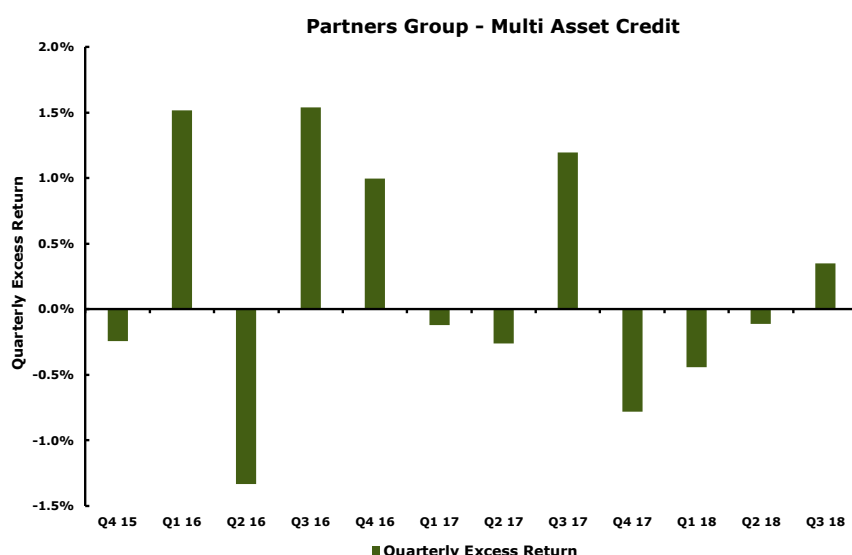
10 Partners Group – Multi Asset Credit

Partners Group was appointed to manage a multi asset credit mandate with the aim of outperforming the 3 month Sterling LIBOR benchmark by 4% p.a. The manager has an annual management fee and performance fee.

10.1 Multi Asset Credit - Investment Performance to 30 September 2018

	Last Quarter (%)	One Year (%)	Two Years (% p.a.)	Three Years (% p.a.)
Partners Group MAC - Gross of fees	1.7	4.5	5.8	6.2
Net of fees ⁽¹⁾	1.5	3.6	4.9	5.3
Benchmark / Target	1.2	4.6	4.5	4.5
Net performance relative to Benchmark	0.3	-1.0	0.4	0.8

Source: Northern Trust. Relative performance may not tie due to rounding.



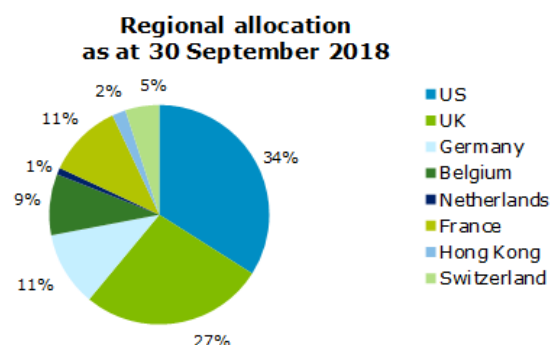
The Fund outperformed its target by 0.3% over the quarter on a net of fees basis.

Over the 12 month period to 30 September 2018, net of fees, the Fund returned 3.6%, underperforming the target by 1.0%.

The Fund returned 5.3% p.a. net of fees over the 3 year period to 30 September 2018, outperforming the target by 0.8% p.a.

10.2 Asset Allocation

The chart below shows the regional split of the Fund as at 30 September 2018.



Note: Based on information provided by Partners Group.

The table below shows details of the Fund's five largest holdings based on net asset value as at 30 September 2018.

Investment	Description	Type of Debt	Tranche	Maturity Date	Current IRR (%)	NAV (£m)	% of NAV
Mirion Technologies, Inc.	US Electronic company	Corporate	First Lien	31 Mar 2022	6.7	8.3	9.7%
		Corporate	Second Lien	31 Mar 2023	9.5	6.6	
AS Adventure	Large European specialist multi-brand outdoor retail group	Corporate	First Lien	28 Apr 2022	5.6	14.3	9.3%
IDEMIA	Security and identity solutions company	Corporate	Mezzanine	31 May 2027	12.9	10.7	7.0%
Springer Science & Business Media	German based book, e-book and journal publisher	Corporate	First Lien	15 Aug 2022	5.2	10.0	6.5%
Sabre Industries	US infrastructure products and services provider	Corporate	First Lien	29 May 2022	6.6	9.9	6.4%

Note: Information provided by Partners Group. Current IRR is net of cost and fees of the investment partner but gross of Partners Group fees. For investments with a holding period less than 12 months, the IRR is not annualised.

10.3 Fund Activity

To date, the Fund has made investments in 54 companies, of which 30 have been fully realised as one further realisation took place during the third quarter. The Fund's 3 year investment period ended in July 2017 and, therefore, any investments realised have subsequently been repaid to investors.

During the third quarter, the MAC 2014 Fund realised its debt investment in Ammeraal Beltech, a Dutch conveyor belt manufacturer, as part of a sale of the company.

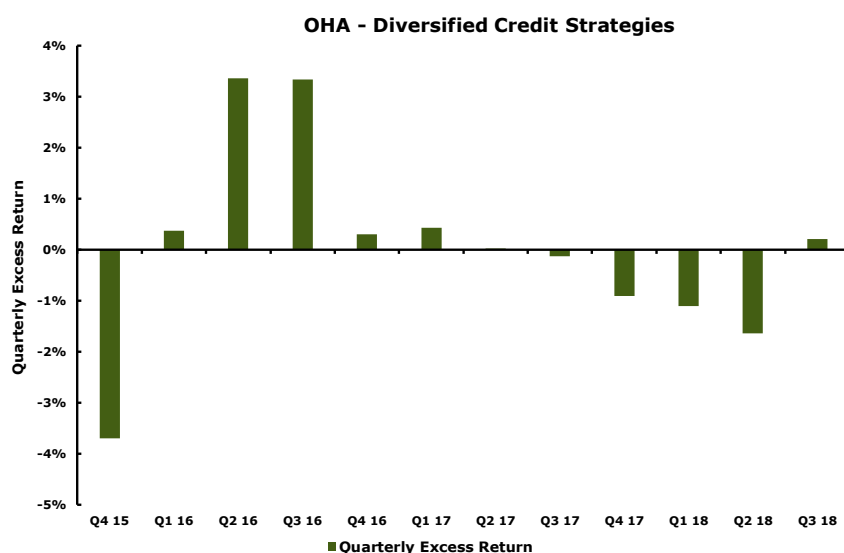
11 Oak Hill Advisors – Diversified Credit Strategies Fund

Oak Hill Advisors was appointed to manage a multi asset credit mandate with the aim of outperforming the 3 month Sterling LIBOR benchmark by 4% p.a. The manager has an annual management fee and performance fee.

11.1 Diversified Credit Strategies - Investment Performance to 30 September 2018

	Last Quarter (%)	One Year (%)	Two Years (%)	Three Years (% p.a.)
OHA – Gross of fees	1.6	1.8	3.7	5.3
Net of fees ⁽¹⁾	1.4	1.1	3.0	4.6
Benchmark / Target	1.2	4.6	4.5	4.5
Net Performance relative to Benchmark	0.2	-3.5	-1.5	0.1

Source: Northern Trust. Relative performance may not tie due to rounding.



Over the quarter the Diversified Credit Strategies Fund returned 1.4% net of fees in absolute terms, outperforming its target by 0.2%. The Fund underperformed a blended benchmark of high yield and leveraged loans by 0.3% over the quarter to 30 September 2018.

The Fund returned 1.1% net of fees over the longer 12 months period to 30 September 2018, underperforming its target by 3.5%. The Fund's underperformance versus its cash +4% target over the year has largely been down to relatively poor performance in the High Yield and Loans space over this period, with Q1 18 being particularly poor for High Yield. OHA continue to outperform the broader markets, and are ahead of target over longer periods.

12 Partners Group – Direct Infrastructure

Partners Group was appointed to manage a global infrastructure mandate with the aim of outperforming the 3 month Sterling LIBOR benchmark by 8% p.a. The manager has an annual management fee and performance fee.

12.1 Direct Infrastructure - Investment Performance to 30 September 2018

Activity

The Fund continued to build up its portfolio over the quarter, which comprised thirteen active investments as at 30 September 2018.

During the third quarter of 2018, the Fund added four new investments to its portfolio: Grassroots Renewable Energy Platform, Murra Warra Wind Farm, Superior Pipeline Company and Techem AG.

The Fund's commitment level increased from 48.3% to 55.6% over the quarter to 30 September 2018.

Capital Calls and Distributions

10 July

- The Fund issued its 16th capital call, drawing down an additional c. 7.9% (€85m).
- Total drawn down following this call was c. 28.4%.

26 October

- The Fund issued its 17th capital call, drawing down an additional c. 2.3% (€25m).
- Total drawn down following this call was c. 30.7%.

Pipeline

Partners Group currently has two opportunities in its near-term investment pipeline:

- A European air cargo logistics provider and a North American support infrastructure in the natural gas value chain.

Investments Held

The table below shows a list of the investments held by the Partners Group Direct Infrastructure Fund as at 30 September 2018.

Investment	Description	Type	Sector	Country	Commitment Date
Fermaca	Gas infrastructure operator based in Mexico.	Lead	Energy	Mexico	July 2015
Silicon Ranch	Solar platform based in US	Lead	Solar Power	USA	April 2016
Axia NetMedie	Internet and data network provider based in Canada and France	Lead	Communication	Canada & France	July 2016
Merkur Offshore	Wind farm based in German North Sea.	Lead	Wind Power	Germany	August 2016
Green Island Renewable Solar Platform	Solar power platform in Taiwan.	Lead	Solar Power	Taiwan	September 2016
High Capacity Metro Trains PPP	Delivery and maintenance of rolling stock for Australian State government.	Co-lead	Transportation	Australia	November 2016
USIC	Utility location services	Lead	Utilities	USA	August 2017
Arcanum Infrastructure	Develops and acquires infrastructure assets to supply strategic materials	Lead	Chemical Infrastructure	North America	tbc
Borssele III/IV	Wind farm based in Netherlands	Lead	Wind Power	Netherlands	tbc
Grassroots Renewable Energy Platform*	Wind/solar/energy storage platform	Lead	Renewable Energy	Australia	tbc
Murra Warra Wind Farm*	Onshore windfarm	Lead	Renewable Energy	Australia	tbc
Superior Pipeline Company*	LNG pipeline platform	Co-lead	Energy Infrastructure	North America	tbc
Techem AG*	Energy metering services provider	Lead	Infrastructure Services	Germany	tbc

*Committed in Q3 2018.

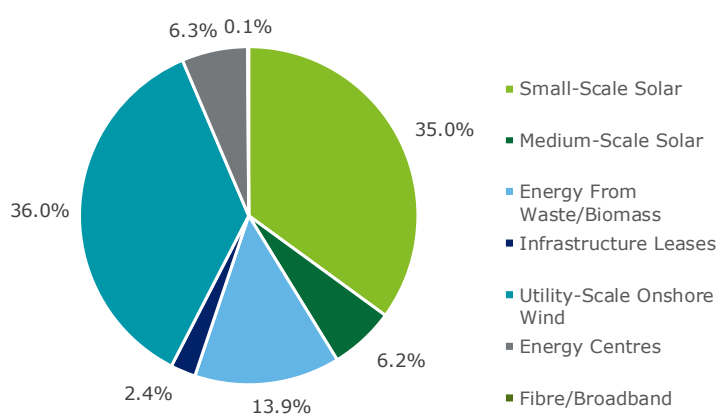
13 Aviva Investors – Infrastructure Income

Aviva Investors was appointed to manage an infrastructure income mandate with the aim of outperforming the 3 month Sterling LIBOR benchmark by 6% p.a. The manager has an annual management fee and performance fee.

13.1 Infrastructure Income - Investment Performance to 30 June 2018

Sector Breakdown

The chart below shows the split of the portfolio by sector.



Source: Aviva Investors.

Small-scale solar and utility-scale onshore wind make up c. 70% of the portfolio.

Holdings

The top 10 holdings in the Infrastructure Income Fund account for c. 60.2% of the Fund and are detailed below.

Top 10 holdings as at 30 June 2018	Asset	Proportion of Fund
Brockloch Rig Wind Farm	Utility-scale Onshore Wind	10.6%
Minnygap Energy	Utility-scale Onshore Wind	6.6%
Turncole Wind Farm	Utility-scale Onshore Wind	6.4%
Aviva Investors Energy Centres No. 1	Energy Centres	6.3%
EES Operations 1	Small-scale Solar PV	6.1%
HomeSun	Small-scale Solar PV	6.0%
Biomass UK No. 2	Biomass	4.9%
Biomass UK No. 1	Biomass	4.8%
Jacks Lane	Utility-scale Onshore Wind	4.4%
Biomass UK No. 3	Biomass	4.3%
Total		60.2%

Note: The numbers in this table may not sum due to rounding.

Source: Aviva Investors.

Pipeline

Aviva currently has a “priority pipeline”, representing transactions which the Fund has exclusivity, are in due diligence or are strongly positioned due to Aviva’s leading position in the relevant sector or relationship with the opportunity partner. As at 30 June 2018, the priority pipeline opportunities total c. £462.9m and expect to reach a close within 12 months. This pipeline is constructed of c. 54% energy from waste/biomass assets, c. 28% infrastructure leases and c. 12% fibre/broadband assets.

Over the quarter to 30 September 2018, the Fund provided a c. £55m funding facility to Truespeed, a provider of rural fibre broadband networks. The investment is the second tranche of finance to the project alongside another Aviva Investors’ mandate. The funding finances the construction of new networks.

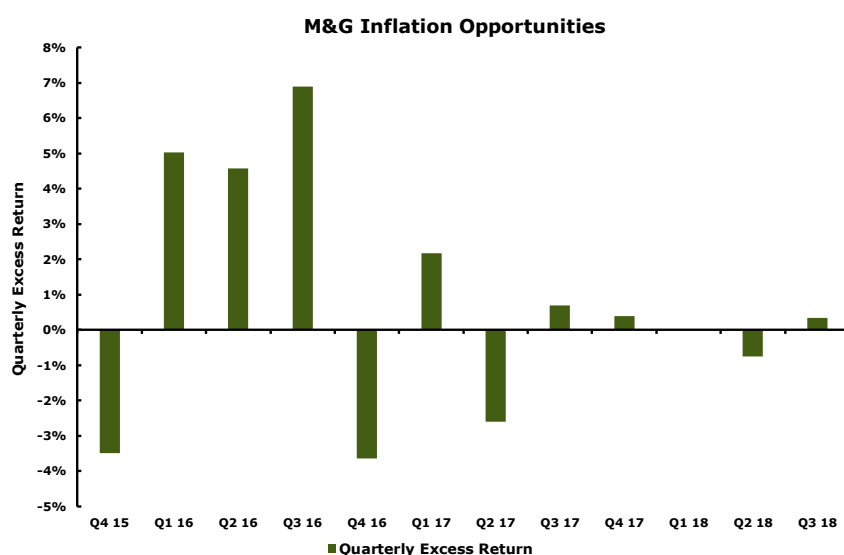
14 M&G – Inflation Opportunities

M&G was appointed to manage an inflation opportunities mandate with the aim of outperforming the RPI benchmark by 2.5% p.a. The manager has an annual management fee which is calculated based on the underlying assets

14.1 M&G Inflation Opportunities - Investment Performance to 30 September 2018

	Last Quarter (%)	One Year (%)	Two Years (% p.a.)	Three Years (% p.a.)
M&G Inflation Opportunities – Gross of fees	1.9	6.1	4.5	9.1
Net of fees ⁽¹⁾	1.9	5.7	4.2	8.7
Benchmark / Target	1.5	5.8	6.1	5.5
Net Performance relative to Benchmark	0.3	0.0	-1.8	3.2

Source: Northern Trust. Relative performance may not tie due to rounding.



Over the third quarter of 2018 the Fund returned 1.9% net of fees, outperforming the performance target by 0.3%. The Fund has performed in line with benchmark over the longer 12 month period to 30 September 2018, delivering a return of 5.7% net of fees

The Fund has again reduced its exposure to index-linked gilts over the quarter, with exposure now standing at c. 32%. Long lease property is now the largest component of the portfolio with exposure increasing to c. 34%, income strips increasing to c. 23% and ground rents exposure increasing slightly to c. 10%.

15 Aberdeen Standard Investments – Long Lease Property

Aberdeen Standard Investments was appointed to manage a long lease property mandate with the aim of outperforming the FT British Government All Stocks Index benchmark by 2.0% p.a. The manager has an annual management fee.

15.1 Long Lease Property - Investment Performance to 30 September 2018

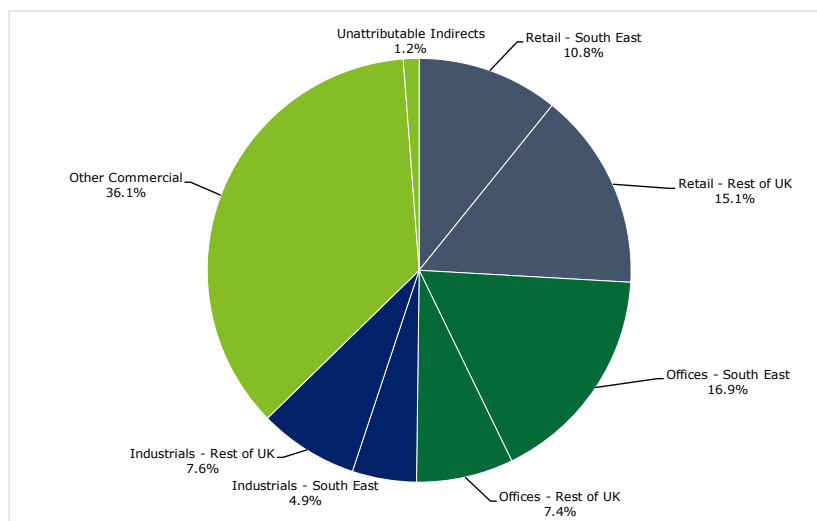
	Last Quarter (%)	One Year (%)	Two Years (% p.a.)	Three Years (% p.a.)
ASI Long Lease Property – Gross of fees	1.9	8.8	9.7	8.1
<i>Net of fees⁽¹⁾</i>	1.8	8.3	9.2	7.5
Benchmark / Target	-1.2	2.6	0.5	5.0
Net Performance relative to Benchmark	3.0	5.7	8.7	2.5

Source: Northern Trust. Relative performance may not tie due to rounding.

The ASI Long Lease Property Fund outperformed its FTSE Gilt All Stocks Index + 2% benchmark by 3.0%, returning 1.8% on a net of fees basis over the third quarter of 2018.

15.2 Portfolio Holdings

The sector allocation in the Long Lease Property Fund as at 30 September 2018 is shown in the graph below.



The Fund's holdings in the office sector has increased slightly from 22.9% as at 30 June 2018 to 24.3% as at 30 September 2018.

Throughout the third quarter, the Fund's industrial weight decreased from 12.9% to 12.5%, while the "other" weighting has increased slightly from 37.2% to 37.3%.

The table below shows details of the top ten tenants in the Fund measured by percentage of net rental income:

Tenant	Total Rent £m p.a.	% Net Income
Tesco	8.2	8.4
Whitbread	6.4	6.6
Sainsbury's	5.0	5.1
Marston's	4.9	5.1
Asda	4.4	4.5
QVC	4.0	4.1
Salford University	4.0	4.1
Save The Children	3.8	3.9
Park Holidays UK Limited	3.6	3.7
Steinhoff	3.6	3.7
Total	48.1	49.2 *

*Total may not equal sum of values due to rounding

The top 10 tenants contribute 49.2% of the total net income into the Fund. Supermarkets continue to make up a significant part of the fund with Tesco, Sainsbury's and Asda contributing 18.0% to the Fund's total net rental income as at 30 September 2018.

The Fund's average unexpired lease term increased over the quarter from 26.5 years to 26.7 years.

The proportion of the Fund's income with fixed, CPI or RPI rental increases increased from 93.7% to 94.0% over the quarter.

15.3 Sales and Purchases

Over the third quarter of 2018:

- The Fund finalised the sale and leaseback of an office asset in Bristol for £51.9m, representing a net initial yield of 4.5%. This 85,000 sq. ft. Grade A office was let to Imperial Brands on a 20 year lease. The lease has five-yearly, upward-only reviews and is CPI-linked with a cap and collar of 4% and 0% p.a. respectively.
- The Fund also purchased a further three holiday parks in Suffolk and Kent operated by Park Holidays UK Limited for £21.8m, reflecting a net initial yield of 3.1%. This was an off-market transaction given ASI's previous relationship with the company, acquiring another portfolio in 2017. The transaction was structured on a ground rent basis with a lease term of 99 years and annual rent set at 12% of the underlying earnings for each park.

Appendix 1 – Fund and Manager Benchmarks

The tables in this Appendix detail the benchmarks and outperformance targets, for the Total Fund and each individual manager.

Total Fund

Inception: 31 December 1999.

Manager	Asset Class	Allocation	Benchmark	Inception Date
Majedie	UK Equity	15.0%	FTSE All-Share Index +2% p.a. over three year rolling periods	31/08/05
LGIM	Global Equity	30.0%	FTSE All World Index	30/11/15
Ruffer	Dynamic Asset Allocation	10.0%	3 Month Sterling LIBOR +4% p.a.	31/07/08
Insight	Bonds Plus	10.0%	3 Month Sterling LIBOR +2% p.a.	30/09/15
Invesco	Private Equity	0.0%	n/a	30/09/09
Unigestion	Private Equity	0.0%	n/a	30/09/09
Partners Group	Multi Asset Credit	5.0%	3 Month Sterling LIBOR +4% p.a.	28/01/15
Oak Hill Advisors	Multi Asset Credit	7.5%	3 Month Sterling LIBOR +4% p.a.	01/05/15
Partners Group	Infrastructure Fund	5.0%	3 Month Sterling LIBOR +8% p.a.	31/08/2015
Aviva Investors	Infrastructure Income Fund	2.5%	FT British Government Index-Linked All Stocks Index +2.0%	23/05/2018
M&G	Inflation Opportunities	10.0%	RPI +2.5%	01/05/15
Aberdeen Standard Investments	Long Lease Property	5.0%	FT British Government All Stocks Index +2.0%	09/04/15
	Total	100.0%		

Note, for the benchmark performance calculation, we assume a 10% allocation to Partners Group MAC and Oak Hill Advisors MAC, and 0% allocation to Partners Group Infrastructure. This will be re-weighted as the Infrastructure Fund is drawn down.

Appendix 2 – Manager Ratings

Based on our manager research process, we assign ratings to the investment managers for specific products or services. The ratings are based on a combination of quantitative and qualitative factors, where the inputs for the qualitative factors come from a series of focused meetings with the investment managers. The ratings reflect our expectations of the future performance of the particular product or service, based on an assessment of:

- The manager's business management;
- The sources of ideas that go to form the portfolio ("alpha generation");
- The process for including the ideas into the portfolio ("alpha harnessing"); and
- How the performance is delivered to the clients.

On the basis of the research and analysis, managers are rated from 1 (most positive) to 4 (most negative), where managers rated 1 are considered most likely to deliver outperformance, net of fees, on a reasonably consistent basis. Managers rated 1 will typically form the basis of any manager selection short-lists.

Where there are developments with an investment manager that cause an element of uncertainty we will make the rating provisional for a short period of time, while we carry out further assessment of the situation.

Appendix 3 – Risk warnings & Disclosures

- Past performance is not necessarily a guide to the future.
- The value of investments may fall as well as rise and you may not get back the amount invested.
- Income from investments may fluctuate in value.
- Where charges are deducted from capital, the capital may be eroded or future growth constrained.
- Investors should be aware that changing investment strategy will incur some costs.
- Any recommendation in this report should not be viewed as a guarantee regarding the future performance of the products or strategy.

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Appendix 3: Cashflow Monitoring Position as at 30 September 2018

Pension Fund current account cashflow actuals and forecast for period July 2018 to June 2019

	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19
	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s
	Actual	Actual	Actual	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast
Balance b/f	6,604	5,365	3,713	4,131	2,731	1,331	1,431	4,031	2,631	2,731	9,231	7,831
Contributions	2,114	2,130	2,045	2,000	2,000	2,000	2,000	2,000	2,000	9,900	2,000	2,000
Pensions	(2,704)	(2,720)	(2,715)	(2,800)	(2,800)	(2,800)	(2,800)	(2,800)	(2,800)	(2,800)	(2,800)	(2,800)
Lump Sums	(484)	(281)	(576)	(600)	(600)	(600)	(600)	(600)	(600)	(600)	(600)	(600)
Net TVs in/(out)	(149)	188	(669)	200	200	200	200	200	200	200	200	200
Expenses	(16)	(969)	(235)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)
Net Cash in/(out) in month	(1,239)	(1,652)	(2,150)	(1,400)	(1,400)	(1,400)	(1,400)	(1,400)	(1,400)	6,500	(1,400)	(1,400)
Net movements from invested cash (see overleaf)							4000					
LCIV Distributions			2,568			1500			1500			1500
Balance c/f	5,365	3,713	4,131	2,731	1,331	1,431	4,031	2,631	2,731	9,231	7,831	7,931

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Current account cashflow actuals compared to forecast during the July to September 2018 quarter

	Jul-18		Aug-18		Sep-18		Jul-Sep 17
	Forecast	Actual	Forecast	Actual	Forecast	Actual	Variance
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Contributions	2,000	2,114	2,000	2,130	2,000	2,045	289
Pensions	(2,800)	(2,704)	(2,800)	(2,720)	(2,800)	(2,715)	261
Lump Sums	(450)	(484)	(450)	(281)	(450)	(576)	9
Net TVs in/(out)	500	(149)	500	188	500	(669)	(2,130)
Expenses	(200)	(16)	(200)	(969)	(200)	(235)	(620)
Withdrawals from fund managers	0	0	0	0	0	0	0
LCIV Distributions	0	0	0	0	0	2,568	2,568
Total	(950)	(1,239)	(950)	(1,652)	(950)	418	377

Notes on variances in quarter:

- Net TVs In over the quarter were lower than forecast by £2.1m.
- Lump Sums were in line with the forecast showing very little variance.
- LCIV distributions of £2.5m was received during the quarter. This had not been previously included in the forecast but it has been included going forward now.
- No manager drawdowns were required during quarter due to LCIV distributions.

Actuals and forecast of invested cash balance for period April 2018 to March 2019

	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19
	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s
	Actual	Actual	Actual	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast	F'cast
Balance b/f	22,086	23,538	25,709	26,865	26,865	26,165	26,184	22,184	23,684	23,703	23,703	25,203
Interest	0	0	19	0	0	19	0	0	19	0	0	12
Distributions												
Private Equity												
Multi Asset Credit	1,452	2,171			1,500			1,500			1,500	
Infrastructure			1,137									
Drawdowns paid to Infrastructure funds												
Partners Infrastructure					(1,200)							
Aviva Infrastructure					(1,000)							
Paid to/from current account (see table above)	0	0	0	0	0	0	(4,000)	0	0	0	0	0
Balance c/f	23,538	25,709	26,865	26,865	26,165	26,184	22,184	23,684	23,703	23,703	25,203	25,215

The forecast indicates that there should be sufficient cash available to fund pension payments and infrastructure drawdowns for the rest of 2018/19.

London Borough of Hammersmith & Fulham Pension Fund Risk Register - Investment Risk														
Risk Group	New	Risk Ref.	Previous	Risk Description	Impact				Likelihood	Total risk score	Mitigation actions	Revised Likelihood	Net risk score	Reviewed on
					Fund	Employers	Reputation	Total						
Funding		1		Scheme members live longer than expected leading to higher than expected liabilities.	5	5	1	11	3	33	Review at each triennial valuation and challenge actuary as required	3	33	05/11/2018
Governance	*	2		That the London Collective Investment Vehicle (LCIV) disbands or the partnership fails to produce proposals/solutions deemed sufficiently ambitious.	5	4	3	12	3	36	TOLERATE - 1) Partners for the pool have similar expertise and like-mindedness of the officers and members involved with the fund, ensuring compliance with the pooling requirements. Ensure that ongoing fund and pool proposals are comprehensive and meet government objectives. Member presence on Shareholder Committee and officer groups.	2	24	05/11/2018
Funding		3		Transfers out increase significantly as members transfer to DC funds to access cash through new pension freedoms.	4	4	2	10	2	20	Monitor numbers and values of transfers out being processed. If required, commission transfer value report from Fund Actuary for application to Treasury for reduction in transfer values.	2	20	05/11/2018
Funding	*	4		Employee pay increases are significantly more than anticipated for employers within the Fund.	4	4	2	10	2	20	TOLERATE - 1) Fund employers should monitor own experience. 2) Assumptions made on pay and price inflation (for the purposes of IAS19/FRS102 and actuarial valuations) should be long term assumptions. Any employer specific assumptions above the actuary's long term assumption would lead to further review. 3) Employers to made aware of generic impact that salary increases can have upon the final salary linked elements of LGPS benefits (accrued benefits before 1 April 2014).	2	20	05/11/2018
Investment	*	5		Significant volatility and negative sentiment in global investment markets following disruptive politically inspired events in US.	5	4	1	10	3	30	TREAT- 1) Continued dialogue with investment managers re management of political risk in global developed markets. 2) Investment strategy involving portfolio diversification and risk control. 3) Investment strategy review will follow post actuarial 2019 valuation.	2	20	05/11/2018
Funding	*	6		Price inflation is significantly more than anticipated in the actuarial assumptions: an increase in CPI inflation by 0.1% over the assumed rate will increase the liability valuation by upwards of 1.7%	5	3	2	10	3	30	TREAT- 1) The fund holds investment in index-linked bonds (RPI protection which is higher than CPI) and other real assets to mitigate CPI risk. Moreover, equities will also provide a degree of inflation protection.	2	20	05/11/2018
Investment	*	7		Investment managers fail to achieve benchmark/ outperformance targets over the longer term: a shortfall of 0.1% on the investment target will result in an annual impact of £1.4m.	5	3	1	9	3	27	TREAT- 1) The Investment Management Agreements (IMAs)clearly state WCC's expectations in terms of investment performance targets. 2) Investment manager performance is reviewed on a quarterly basis. 3) The Pension Fund Committee should be positioned to move quickly if it is felt that targets will not be achieved.. 4) Portfolio rebalancing is considered on a regular basis by the Pension Fund Committee. 5) The Fund's investment management structure is highly diversified, which lessens the impact of manager risk compared with less diversified structures.	2	18	05/11/2018

Investment	*	8	16	Volatility caused by uncertainty with regard to the withdrawal of the UK from the European Union, lack of any trade deal struck by 29 March 2019 and the economic after effects.	4	4	1	9	3	27	TREAT- 1) Officers to consult and engage with advisors and investment managers. 2) Future possibility of looking at move from UK to Global benchmarks on UK Equities and UK Property. 3) Possibility of hedging currency and equity index movements.	2	18	05/11/2018
Investment	*	9		Increased risk to global economic stability. Outlook deteriorates in advanced economies because of heightened uncertainty and setbacks to growth and confidence, with declines in oil and commodity prices. Leading to tightened financial conditions, reduced risk appetite and raised credit risks. Geo-political risk as a result of events and political uncertainty.	4	3	1	8	3	24	TREAT- 1) Increased vigilance and continued dialogue with managers as to events on and over the horizon. 2) Continued investment strategy involving portfolio diversification and risk control. 3) Investment strategy review will follow post actuarial 2019 valuation.	2	16	05/11/2018
Funding	*	10		Impact of economic and political decisions on the Pension Fund's employer workforce.	5	2	1	8	2	16	TREAT- 1) Barnet Waddingham uses prudent assumptions on future of employees within workforce. Employer responsibility to flag up potential for major bulk transfers outside of the Westminster Fund. The potential for a significant reduction in the workforce as a result of the public sector financial pressures may have a future impact on the Fund. 2) Need to make prudent assumptions about diminishing workforce when carrying out the triennial actuarial valuation.	2	16	05/11/2018
Governance		11		London CIV has inadequate resources to monitor the implementation of investment strategy and as a consequence are unable to address underachieving fund managers.	3	3	2	8	3	24	Pension Fund Committee Chair is a member of the Joint member Committee responsible for the oversight of the CIV and can monitor and challenge the level of resources through that forum. Tri-Borough Director of Treasury & Pensions is a member of the officer Investment Advisory Committee which gives the Fund influence over the work of the London CIV.	2	16	05/11/2018
Operational	*	12		Procurement processes may be challenged if seen to be non-compliant with OJEU rules. Poor specifications lead to dispute. Unsuccessful fund managers may seek compensation following non compliant process	2	2	3	7	2	14	TOLERATE - Ensure that assessment criteria remains robust and that full feedback is given at all stages of the procurement process.	2	14	05/11/2018
Funding		13		Ill health costs may exceed "budget" allocations made by the actuary resulting in higher than expected liabilities particularly for smaller employers.	4	2	1	7	2	14	Review "budgets" at each triennial valuation and challenge actuary as required. Charge capital cost of ill health retirements to admitted bodies at the time of occurring. Occupational health services provided by the Council and other large employers to address potential ill health issues early.	2	14	05/11/2018
Funding	*	14		Impact of increases to employer contributions following the actuarial valuation	5	5	3	13	2	26	TREAT- 1) Officers to consult and engage with employer organisations in conjunction with the actuary. 2) Actuary will assist where appropriate with stabilisation and phasing in processes.	1	13	05/11/2018

Funding	*	15		Changes to LGPS Scheme moving from Defined Benefit to Defined Contribution	5	3	2	10	2	20	TOLERATE - 1) Political power required to effect the change.	2	20	05/11/2018
Governance	*	16		Changes to LGPS Regulations	3	2	1	6	2	12	TREAT - 1) Fundamental change to LGPS Regulations implemented from 1 April 2014 (change from final salary to CARE scheme). 2) Future impacts on employer contributions and cash flows will be considered during the 2016 actuarial valuation process. 3) Fund will respond to consultation processes. 4) Impact of LGPS (Management of Funds) Regulations 2016 to be monitored. Impact of Regulations 8 (compulsory pooling) to be monitored.	2	12	05/11/2018
Governance	*	17		Failure to take difficult decisions inhibits effective Fund management	5	3	4	12	2	24	TREAT-1) Officers ensure that governance process encourages decision making on objective empirical evidence rather than emotion. Officers ensure that the basis of decision making is grounded in the Investment Strategy Statement (ISS), Funding Strategy Statement (/FSS), Governance policy statement and Committee Terms of Reference and that appropriate advice from experts is sought	1	12	05/11/2018
Funding		18		There is insufficient cash available in the Fund to meet pension payments leading to investment assets being sold at sub-optimal prices to meet pension payments.	5	4	2	11	2	22	Cashflow forecast maintained and monitored. Cashflow position reported to sub-committee quarterly. Cashflow requirement is a factor in current investment strategy review.	1	11	05/11/2018
Funding	*	19	4	Mismatching of assets and liabilities, inappropriate long-term asset allocation or investment strategy, mistiming of investment strategy	5	3	3	11	2	22	TREAT- 1) Active investment strategy and asset allocation monitoring from Pension Fund Committee, officers and consultants. 2) Investment strategy review is currently underway with an approved switch from equities to fixed income. 3) Setting of Fund specific benchmark relevant to the current position of fund liabilities. 4) Fund manager targets set and based on market benchmarks or absolute return measures. Overall investment benchmark and out-performance target is fund specific.	1	11	05/11/2018
Financial	*	20		Financial loss of cash investments from fraudulent activity	3	3	5	11	2	22	TREAT - 1) Policies and procedures are in place which are regularly reviewed to ensure risk of investment loss is minimised. Strong governance arrangements and internal control are in place in respect of the Pension Fund. Internal Audit assist in the implementation of strong internal controls. Fund Managers have to provide annual SSAE16 and ISAE3402 or similar documentation (statement of internal controls).	1	11	05/11/2018
Operational	*	21		Failure to hold personal data securely in breach of General Data Protection Regulation (GDPR) legislation.	3	3	5	11	2	22	TREAT - 1) Data encryption technology is in place which allow the secure transmission of data to external service providers. 2) Phasing out of holding records via paper files. 3) Pensions Admin (Surrey County Council) manual records are locked daily in a secure safe. 4) WCC IT data security policy adhered to.	1	11	05/11/2018
Governance		22		Failure to comply with legislation leads to ultra vires actions resulting in financial loss and/or reputational damage.	5	2	4	11	2	22	Officers maintain knowledge of legal framework for routine decisions. Eversheds retained for consultation on non-routine matters.	1	11	05/11/2018

Funding		23		Failure of an admitted or scheduled body leads to unpaid liabilities being left in the Fund to be met by others.	5	3	3	11	2	22	Transferee admission bodies required to have bonds in place at time of signing the admission agreement. Regular monitoring of employers and follow up of expiring bonds.	1	11	05/11/2018
Governance		24		Inadequate, inappropriate or incomplete investment or actuarial advice is actioned leading to a financial loss or breach of legislation.	5	3	2	10	2	20	At time of appointment ensure advisers have appropriate professional qualifications and quality assurance procedures in place. Committee and officers scrutinise and challenge advice provided.	1	10	05/11/2018
Operational	*	25		Financial failure of third party supplier results in service impairment and financial loss	5	4	1	10	2	20	TOLERATE - 1) Performance of third parties (other than fund managers) regularly monitored. 2) Regular meetings and conversations with global custodian (Northern Trust) take place. 3) Actuarial and investment consultancies are provided by two different providers.	1	10	05/11/2018
Governance	*	26		Change in membership of Pension Fund Committee leads to dilution of member knowledge and understanding	2	2	1	5	4	20	TREAT - 1) Succession planning process in place. 2) Ongoing training of Pension Fund Committee members. 3) Pension Fund Committee new member induction programme. 4) Training to be based on the requirements of CIPFA Knowledge and Skills Framework under designated officer.	2	10	05/11/2018
Investment		27		Failure of global custodian or counterparty.	5	3	2	10	2	20	At time of appointment, ensure assets are separately registered and segregated by owner. Review of internal control reports on an annual basis. Credit rating kept under review.	1	10	05/11/2018
Operational	*	28	9	Financial failure of a fund manager leads to value reduction, increased costs and impairment.	4	3	3	10	2	20	TREAT - 1) Fund is reliant upon current adequate contract management activity. 2) Fund is reliant upon alternative suppliers at similar price being found promptly. 3) Fund is reliant on LGIM as transition manager. 4) Fund has the services of the London Collective Investment Vehicle (LCIV).	1	10	05/11/2018
Investment	*	29		Global investment markets fail to perform in line with expectations leading to deterioration in funding levels and increased contribution requirements from employers.	5	3	2	10	2	20	TREAT- 1) Proportion of total asset allocation made up of equities, bonds, property funds and fixed income, limiting exposure to one asset category. 2) The investment strategy is continuously monitored and periodically reviewed to ensure optimal risk asset allocation. 3) Actuarial valuation and strategy review take place every three years post the actuarial valuation. 4) IAS19 data is received annually and	1	10	05/11/2018
Operational	*	30		Inaccurate information in public domain leads to damage to reputation and loss of confidence	1	1	3	5	3	15	TOLERATE - 1) Ensure that all requests for information (Freedom of Information, member and public questions at Council, etc) are managed appropriately and that Part 2 Exempt items remain so. 2) Maintain constructive relationships with employer bodies to ensure that news is well managed. Stage AGM every year.	2	10	05/11/2018
Governance		31		Officers do not have appropriate skills and knowledge to perform their roles resulting in the service not being provided in line with best practice and legal requirements. Succession planning is not in place leading to reduction of knowledge when an officer leaves.	4	3	3	10	2	20	Person specifications are used at recruitment to appoint officers with relevant skills and experience. Training plans are in place for all officers as part of the performance appraisal arrangements. Shared service nature of the pensions team provides resilience and sharing of knowledge.	1	10	05/11/2018

Governance	*	32	29	Failure to comply with legislative requirements e.g. ISS, FSS, Governance Policy, Freedom of Information requests	3	3	4	10	2	20	TOLERATE - 1) Publication of all documents on external website. 2) Managers expected to comply with ISS and investment manager agreements. 3) Local Pension Board is an independent scrutiny and assistance function. 4) Annual audit reviews.	1	10	05/11/2018
Funding		33		Scheme matures more quickly than expected due to public sector spending cuts, resulting in contributions reducing and pension payments increasing.	5	3	1	9	2	18	Review maturity of scheme at each triennial valuation. Deficit contributions specified as lump sums, rather than percentage of payroll to maintain monetary value of contributions. Cashflow position monitored monthly.	1	9	05/11/2018
Governance		34		Committee members do not have appropriate skills or knowledge to discharge their responsibility leading to inappropriate decisions.	4	3	2	9	2	18	External professional advice is sought where required. Knowledge and skills policy in place (subject to Committee Approval)	1	9	05/11/2018
Operational	*	35		Insufficient attention paid to environmental, social and governance (ESG) issues, leading to reputational damage.	3	2	4	9	2	18	TREAT-1) Review ISS in relation to published best practice (e.g. Stewardship Code) 2) Ensure fund managers are encouraged to engage and to follow the requirements of the published ISS. 3) The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), which raises awareness of ESG issues and facilitates engagement with fund managers and corporate company directors.	1	9	05/11/2018
Financial	*	36		Inaccurate cash flow forecasts or drawdown payments lead to shortfalls on cash levels and borrowing becomes necessary to ensure that funds are available	3	4	2	9	2	18	TREAT - 1) Borrowing limits with banks are set at levels that are more than adequate should cash be required at short notice. 2) Cashflow analysis of pension fund undertaken at regular intervals.	1	9	05/11/2018
Regulation		37		Loss of flexibility to engage with Fund Managers that the fund has not 'opted up' with regard to new products, resulting in reduced knowledge about investment opportunities that may benefit the fund. (The Fund is a retail client to counterparties unless opted up)	5	2	2	9	2	18	More reliance on investment advisor to keep Officers and Committee updated. Officers are considering other financial institution outside of the current mandates to 'opt up' with. Maintaining up to date information about the fund on relevant platforms. Fund can opt up with prospective clients.	1	9	05/11/2018
Governance	*	38		Failure to comply with recommendations from the Local Pension Board, resulting in the matter being escalated to the scheme advisory board and/or the pensions regulator	1	3	5	9	2	18	TOLERATE - 1) Ensure that an cooperative, effective and transparent dialogue exists between the Pension Fund Committee and Local Pension Board.	1	9	05/11/2018
Regulation		39		Loss of 'Elective Professional Status' with any or all of existing Fund managers and counterparties resulting in reclassification of fund from professional to retail client status impacting Fund's investment options.	4	2	2	8	2	16	Keep quantitative and qualitative requirements under review to ensure that they continue to meet the requirements. There is a training programme and log in place to ensure knowledge and understanding is kept up to date. Existing and new Officer appointments subject to requirements for professional qualifications and CPD.	1	8	05/11/2018

Funding		40		The level of inflation and interest rates assumed in the valuation may be inaccurate leading to higher than expected liabilities.	4	2	1	7	2	14	Review at each triennial valuation and challenge actuary as required. Growth assets and inflation linked assets in the portfolio should rise as inflation rises.	1	7	05/11/2018
Regulation		41		Pensions legislation or regulation changes resulting in an increase in the cost of the scheme or increased administration.	4	2	1	7	2	14	Maintain links with central government and national bodies to keep abreast of national issues. Respond to all consultations and lobby as appropriate to ensure consequences of changes to legislation are understood.	1	7	05/11/2018
Governance	*	42		Implementation of proposed changes to the LGPS (pooling) does not conform to plan or cannot be achieved within laid down timescales	3	2	1	6	2	12	TREAT- 1) Officers consult and engage with MHCLG, LGPS Scheme Advisory Board, advisors, consultants, peers, various seminars and conferences. 2) Officers engage in early planning for implementation against agreed deadlines.	1	6	05/11/2018

London Borough of Hammersmith and Fulham Pension Fund Risk Register - Adminstration Risk														
Risk Group	New	Risk Ref.	Previous	Risk Description	Impact				Likelihood	Total risk score	Mitigation actions	Revised likelihood	Total risk score	Reviewed on
					Fund	Employers	Reputation	Total						
Admin	*	1		Bank reconciliations no longer carried out by BT. Income processing from the bank is being brought in house, no process in place yet. HCC may take on the process but no firm guarantee in place yet. Income not being posted to the system increasing workload for the pensions finance team, potentially for errors and accounts inaccuracy.	2	2	2	6	4	24	TREAT 1) Finance at Hammersmith to work with HCC and the Tri-Borough Pensions to come up with a solution to ensure bank reconciliations and income is posted promptly and accurately.	3	18	05/11/2018
Admin	*	2		Structural changes in an employer's membership or an employer fully/partially closing the scheme. Employer bodies transferring out of the pension fund or employer bodies closing to new membership. An employer ceases to exist with insufficient funding or adequacy of bond placement.	5	3	1	9	3	27	TREAT 1) Administering Authority actively monitors prospective changes in membership. 2) Maintain knowledge of employer future plans. 3) Contributions rates and deficit recovery periods set to reflect the strength of the employer covenant. 4) Periodic reviews of the covenant strength of employers are undertaken and indemnity applied where appropriate. 5) Risk categorisation of employers planned to be part of 2019 actuarial valuation. 6) Monitoring of gilt yields for assessment of pensions deficit on a termination basis.	2	18	05/11/2018
Admin	*	3		Concentration of knowledge in a small number of officers and risk of departure of key staff.	2	2	3	7	3	21	TREAT 1) Practice notes in place. 2) Development of team members and succession planning improvements to be implemented. 3) Officers and members of the Pension Fund Committee will be mindful of the proposed CIPFA Knowledge and Skills Framework when setting objectives and establishing training needs.	2	14	05/11/2018
Admin	*	4		Incorrect data due to employer error, user error or historic error leads to service disruption, inefficiency and conservative actuarial assumptions.	4	4	3	11	2	22	TREAT 1) Update and enforce admin strategy to assure employer reporting compliance. 2) Implementation and monitoring of a Data Improvement Plan as part of the Service Specification between the Fund and Orbis. TOLERATE 1) Northern Trust provides 3rd party validation of performance and valuation data. Admin team and members are able to interrogate data to ensure accuracy.	1	11	05/11/2018
Admin		5		Loss of funds through fraud or misappropriation leading to negative impact on reputation of the Fund as well as financial loss.	3	2	5	10	2	20	TREAT 1) Third parties regulated by the FCA and separation of duties and independent reconciliation processes are in place. 2) Review of third party internal control reports. 3) Regular reconciliations of pensions payments undertaken by Pension Finance Team. 4) Periodic internal audits of Pensions Finance and HR Teams.	1	10	05/11/2018
Admin		6		BT contract wind down could lead to problems for retirements in 18/19 where data is on two different systems. All returns must be completed prior to BT contract ceasing. The move to Hampshire CC due in December 2018 and ensuring that key working practices continue such as the pension interface will be a Key to reduce risks to members.	1	2	2	5	2	10	TREAT 1) People Services are working with HCC and BT to ensure service transfer is smooth as possible. 2) 2017/18 LGPS files were checked by People Services in June 2018.	2	10	05/11/2018
Admin		7		Failure of fund manager or other service provider without notice resulting in a period of time without the service being provided or an alternative needing to be quickly identified and put in place.	5	2	2	9	2	18	TREAT 1) Contract monitoring in place with all providers. 2) Procurement team send alerts whenever credit scoring for any provider changes for follow up action.	1	9	05/11/2018

Admin	*	8	Non-compliance with regulation changes relating to the pension scheme or data protection leads to fines, penalties and damage to reputation.	3	3	2	8	2	16	TREAT 1) The Fund has generally good internal controls with regard to the management of the Fund. These controls are assessed on an annual basis by internal and external audit as well as council officers. 2) Through strong governance arrangements and the active reporting of issues, the Fund will seek to report all breaches as soon as they occur in order to allow mitigating actions to take place to limit the impact of any breaches.	1	8	05/11/2018
Admin		9	Failure of financial system leading to lump sum payments to scheme members and supplier payments not being made and Fund accounting not being possible.	1	3	4	8	2	16	TREAT 1) Contract in place with HCC to provide service, enabling smooth processing of supplier payments. 2) Process in place for Surrey CC to generate lump sum payments to members as they are due. 3) Officers undertaking additional testing and reconciliation work to verify accounting transactions.	1	8	05/11/2018
Admin	*	10	Inability to respond to a significant event leads to prolonged service disruption and damage to reputation.	1	2	5	8	2	16	TREAT 1) Disaster recovery plan in place as part of the Service Specification between the Fund and Surrey County Council 2) Ensure system security and data security is in place 3) Business continuity plans regularly reviewed, communicated and tested 4) Internal control mechanisms ensure safe custody and security of LGPS assets. 5) Gain assurance from the Fund's custodian, Northern Trust, regarding their cyber security compliance.	1	8	05/11/2018
Admin		11	Failure of pension payroll system resulting in pensioners not being paid in a timely manner.	1	2	4	7	2	14	TOLERATE 1) In the event of a pension payroll failure, we would consider submitting the previous months BACS file to pay pensioners a second time if a file could not be recovered by the pension administrators and our software suppliers.	1	7	05/11/2018
Admin		12	Administrators do not have sufficient staff or skills to manage the service leading to poor performance and complaints.	1	2	3	6	2	12	TOLERATE 1) Surrey CC administers pensions for Surrey, East Sussex, LB Hillingdon and the Tri-Borough. Service has been excellent since this change was made.	1	6	05/11/2018
Admin		13	Failure to pay pension benefits accurately leading to under or over payments.	2	2	2	6	2	12	TREAT 1) There are occasional circumstances where under/over payments are identified. Where underpayments occur, arrears are paid as soon as possible, usually in the next monthly pension payment. Where an overpayment occurs, the member is contacted and the pension corrected in the next month. Repayment is requested and sometimes we collect this over a number of months.	1	6	05/11/2018
Admin		14	Failure of pension administration system resulting in loss of records and incorrect pension benefits being paid or delays to payment.	1	1	1	3	2	6	TREAT 1) Pension administration records are stored on the Surrey CC servers who have a disaster recovery system in place and records should be restored within 24 hours of any issue, All files are backed up daily.	2	6	05/11/2018
Admin	*	15	Unstructured training leads to under developed workforce resulting in inefficiency.	2	2	2	6	2	12	TREAT 1) Implementation and monitoring of a Staff Training and Competency Plan as part of the Service Specification between the Fund and Surrey County Council.	1	6	05/11/2018
Admin	*	16	Failure to identify GMP liability leads to ongoing costs for the pension fund.	3	2	1	6	1	6	TREAT 1) GMP to be identified as a Project as part of the Service Specification between the Fund and Surrey County Council.	1	6	05/11/2018
Admin	*	17	Lack of guidance and process notes leads to inefficiency and errors.	2	2	1	5	2	10	TREAT 1) Ensure process notes are compiled and circulated in Pension Fund and Administration teams.	1	5	05/11/2018
Admin	*	18	Lack of productivity leads to impaired performance.	2	2	1	5	2	10	TREAT 1) Regular appraisals with focused objectives for pension fund and admin staff.	1	5	05/11/2018
Admin	*	19	Rise in ill health retirements impact employer organisations.	2	2	1	5	1	5	TREAT 1) Engage with actuary re assumptions in contribution rates.	1	5	05/11/2018
Admin	*	20	Rise in discretionary ill-health retirements claims adversely affecting self-insurance costs.	2	2	1	5	1	5	TREAT 1) Pension Fund monitors ill health retirement awards which contradict IRMP recommendations.	1	5	05/11/2018
Admin	*	21	Poor reconciliation process leads to incorrect contributions.	2	1	1	4	2	8	TREAT 1) Ensure reconciliation process notes are understood by Pension Fund team. 2) Ensure that the Pension Fund team is adequately resourced to manage the reconciliation process.	1	4	05/11/2018

Appendix 5: Pension Fund Voting Summary: July to September 2018

The investment managers managing the Fund's assets on a segregated basis are able to report on how they have voted the Fund's specific holdings at AGMs and EGMs of companies the Fund is invested in.

LCIV Majedie voting information is as follows:

VOTING	
No. of companies	3
No. of meetings	4
No. of resolutions	59

LCIV Ruffer voting information is as follows:

VOTING	
No. of companies	9
No. of meetings	14
No. of resolutions	134

LGIM, who manage the global passive equity portfolio on behalf of the Fund, undertake extensive engagement with the companies they are invested in as well as voting. Below is a summary of the meetings they voted at during the April to June 2018 quarter.


VOTING	
No. of companies	399
No. of meetings	620
No. of resolutions	3990

Forward Plan for Pensions Sub-Committee – November 2018

Area of work	Nov 2018	Feb 2019	Jun 2019	Sep 2019
Governance	Quarterly Update Pack Pension Board minutes IBC on-boarding update	Quarterly Update Pack Pension Board minutes MHCLG Consultation	Quarterly Update Pack Business Plan Internal Audit Report Draft Annual Report	Quarterly Update Pack
Investments	Fund Manager monitoring Equity Protection review Low Carbon Strategy	Fund Manager monitoring Fixed income strategy Review London CIV Update	Fund Manager monitoring Annual report to Scheme Advisory Board re pooling arrangements	Fund Manager monitoring
Funding	Funding Update (quarterly update)	Funding Update (quarterly update)	Funding Update (quarterly update)	Funding Update (quarterly update) Actuarial valuation review

Forward Plan for Pensions Board – February 2019

Area of work	February 2019	July 2019
Governance	Quarterly Update Pack IBC on-boarding update GAD Report MHCLG Consultation	Quarterly Update Pack Business Plan Internal Audit Report Draft Annual Report
Investments	Equity Protection review Low Carbon Strategy	Fixed income strategy Review London CIV Update Annual report to Scheme Advisory Board re pooling arrangements
Funding	Funding Update (quarterly update)	Funding Update (quarterly update) Actuarial valuation review

<p>London Borough of Hammersmith & Fulham</p> <p>PENSIONS BOARD</p> <p>6 February 2019</p>	
<p>GOVERNMENT ACTUARIES DEPARTMENT (GAD) REPORT 2016</p>	
<p>Report of the Strategic Director, Finance and Governance</p>	
<p>Open Report</p>	
<p>Classification - For Information</p>	
<p>Key Decision: No</p>	
<p>Wards Affected: None</p>	
<p>Accountable Director: Phil Triggs, Tri Borough Director of Pensions and Treasury</p>	
<p>Report Author: Matt Hopson, Strategic Investment Manager</p>	<p>Contact Details: Tel: 0207 641 4126 E-mail: mhopson@westminster.gov.uk</p>

1. EXECUTIVE SUMMARY

- 1.1 This report and appendices provide the Pensions Board with an update on the Government Actuary's Department's (GAD) report on the 2016 LGPS triennial actuarial valuation outcome.

2. RECOMMENDATIONS

- 2.1 The Board is recommended to note the update.

3 GAD BACKGROUND

- 3.1 Section 13 of the Public Service Pension Schemes Act 2013 requires a "suitably qualified person" appointed by the Secretary of State to carry out a review of actuarial valuations of funded public service pension schemes. In this instance, it is the LGPS scheme on which the report will focus.

- Whether the fund's valuation is in accordance with the scheme regulations.
- Whether the fund's valuation has been carried out in a way which is not inconsistent with the other fund valuations within the LGPS.

- Whether the rate of employer contributions is set at an appropriate level to ensure the solvency of the pension fund.
- Whether the rate of employer contributions is set at an appropriate level to ensure the long-term cost efficiency of the scheme, so far as relating to the pension fund.

3.2 GAD was therefore called upon to perform the analysis of the LGPS. Their initial report and the tests they had used on the individual funds resulted in several warning flags across a large range of funds, prompting a response from the various actuarial firms used in the LGPS to challenge the findings.

3.3 The original report was uncomplimentary of the LGPS and not reflective of the majority of funds being in a strong position. Some of the tests were regarded by LGPS actuaries as being not fit for purpose. It was observed that some LGPS Funds that were in a better funding position were flagged as higher risk due to the counterintuitive nature of their design (the asset shock test being a prime example).

3.4 Upon receiving notable challenges, GAD revised their report and it now reads the LGPS in a more positive light, reflecting the improving funding positions across the board.

3.5 The GAD report and the actuaries' response are attached in the appendices to this report.

4 LBHF GAD POSITION

4.1 The London Borough of Hammersmith and Fulham received green flags across the board on the GAD's various tests. This reflects the Fund is in a relatively strong position.

4.2 On the Scheme Advisory Board's like for like valuation basis, the Hammersmith and Fulham Pension Fund is in the 59th percentile best funded, dropping from 28th on the local basis as at the valuation date 31 March 2016.

5 CONSULTATION

5.1 Not Applicable

6 EQUALITY IMPLICATIONS

6.1 Not applicable

7 LEGAL IMPLICATIONS

7.1 None

8 FINANCE AND RESOURCES IMPLICATIONS

8.1 None

9 IMPLICATIONS FOR BUSINESS

9.1 Not applicable

10 RISK MANAGEMENT

10.1 None

11 PROCUREMENT IMPLICATIONS

11.1 None

12 IT STRATEGY IMPLICATIONS

12.1 None

LIST OF BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
	None		

LIST OF APPENDICES:

Appendix 1: GAD Report

Appendix 2: Actuaries' Response to GAD Report



Government
Actuary's
Department

Local Government Pension Scheme England and Wales

Review of the Actuarial Valuations of
Funds as at 31 March 2016 Pursuant
to Section 13 of the Public Service
Pensions Act 2013

Date: 27 September 2018

Author: Martin Clarke, John Bayliss

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3. Consistency	11
4. Solvency	23
5. Long term cost efficiency	35



1

Introduction

1.1 This report is addressed to the Ministry of Housing, Communities and Local Government (MHCLG) as the responsible authority for the purposes of subsection (4) of section 13 of the Public Service Pensions Act 2013 ('the Act'). GAD has prepared this report to set out the results of our review of the 2016 funding valuations of the Local Government Pension Scheme (LGPS). This report will be of relevance to: administering authorities and other employers, actuaries performing valuations for the funds within the LGPS, the LGPS Scheme Advisory Board (SAB), HM Treasury (HMT) and the Chartered Institute of Public Finance and Accountancy (CIPFA), as well as other LGPS stakeholders.

1.2 In this introduction we provide:

- background information on the LGPS and fund valuations
- background information on this review and section 13 of the Act
- details of the structure of this report, including the executive summary and the appendices
- discussion of the metrics and flags that we have used in this report, noting the significant improvement in outcomes compared with the previous review
- commentary on the role of the actuary and other stakeholders, noting that nothing in this report should be taken as criticism of administering authorities, their actuary, or other stakeholders

- discussion of the data and assumptions underpinning this review
- a note of our engagement with stakeholders
- a statement of compliance and limitations

The Local Government Pension Scheme and fund valuations

- 1.3 The LGPS is a funded scheme and periodic assessments are needed to ensure the fund has sufficient assets to meet its liabilities. Employer contribution rates may change depending on the results of valuations. Scheme regulations set out when valuations are to be carried out.
- 1.4 Each LGPS pension fund is required to appoint its own fund actuary, who carries out the fund's valuation. The fund actuary uses a number of assumptions to value the liabilities of the fund. Liabilities are split between those that relate to the past (the past service cost), and those that relate to the future (the future service cost). The results of the valuation may lead to changes in employer contribution rates for both future and past service costs.

GAD's review and section 13

- 1.5 Section 13 applies for the first time to the valuations as at 31 March 2016.
- 1.6 Subsection (4) of section 13 requires the Government Actuary as the person appointed by MHCLG to report on whether the four main aims are achieved, namely:

- compliance: whether the fund's valuation is in accordance with the scheme regulations
- consistency: whether the fund's valuation has been carried out in a way which is not inconsistent with the other fund valuations within LGPS
- solvency: whether the rate of employer contributions is set at an appropriate level to ensure the solvency of the pension fund
- long term cost efficiency: whether the rate of employer contributions is set at an appropriate level to ensure the long term cost efficiency of the scheme, so far as relating to the pension fund

1.7 Section 13 subsection (6) states that if any of the aims of subsection (4) are not achieved:

- a) the report may recommend remedial steps
- b) the scheme manager must:
 - i) take such remedial steps as the scheme manager considers appropriate
 - ii) publish details of those steps and the reasons for taking them
- c) the responsible authority may
 - iii) require the scheme manager to report on progress in taking remedial steps
 - iv) direct the scheme manager to take such remedial steps as the responsible authority considers appropriate

1.8 A dry run of this exercise was published¹ following the valuations as at 31 March 2013.

Structure of this report

1.9 An executive summary to this report is provided in a separate document.

1.10 In the remaining chapters in this report, we consider each of the four aims of section 13:

- Chapter 2: Compliance
- Chapter 3: Consistency
- Chapter 4: Solvency
- Chapter 5: Long term cost efficiency

1.11 Appendices are contained in a separate document, and cover:

- Appendix A: Compliance
- Appendix B: Consistency
- Appendix C: Solvency
- Appendix D: Long term cost efficiency
- Appendix E: Asset liability study
- Appendix F: Data provided
- Appendix G: Assumptions
- Appendix H: Section 13 of the Public Service Pensions Act 2013
- Appendix I: Extracts from other relevant regulations

Metrics and flags

1.12 In its notes to the establishment of key performance indicators² (KPIs), the Scheme Advisory Board states: "The SAB considers that maintaining and improving the overall performance of the LGPS is best done by focusing on improving key financial and governance metrics of 'under-performing' funds, and concurrently seeking to raise the level of performance of 'average' funds to that of the 'highest performing' funds."

¹ <http://www.lgpsboard.org/images/Reports/Section13DryRun20160711.pdf>

² <http://committees.westminster.gov.uk/documents/s15058/11%20-%20Appendix%201%20-%20KPI%20Guidance.pdf>

1.13 We have looked at a range of metrics to identify potential issues in respect of solvency and long term cost efficiency. Each fund's score under each measure is colour coded or flagged, where:

- indicates that there are no material issues that may contribute to a recommendation for remedial action in order to ensure solvency or long term cost efficiency
- indicates a potential issue should be recognised, but in isolation would not usually contribute to a recommendation for remedial action in order to ensure solvency or long term cost efficiency
- indicates a potentially material issue that may contribute to a recommendation for remedial action in order to ensure solvency or long term cost efficiency

1.14 The trigger points for these flags are based on a combination of absolute measures and measures relative to the bulk of the funds in scope. We have had regard to the particular circumstances of some potential exceptions, following engagement with the administering authority and the fund actuary.

Results

1.15 In total, 70 out of 89 funds tested had green flags on all solvency and long term cost efficiency metrics. This is a significant improvement compared with the previous dry run report (52 out of 90). There are a total of 20 amber and 2 red flags, which is again a significant improvement compared with the dry run (58 amber, 5 red).

Interpretation of flags

1.16 While they should not represent targets, these measures and flags help us determine whether a more detailed review is required, for example, we might have concern where

multiple measures are triggered amber for a given fund.

1.17 In broad terms, amber flags are advisory signals that may indicate action and a need for further investigation through engagement with the relevant administering authority and their actuary. It should be noted that these flags are intended to highlight areas where risk may be present, or further investigation is required. Where an amber flag remains following that engagement, we believe this relates to an area where an issue remains that administering authorities and pension boards should be aware of. There is no implication that the administering authority was previously unaware of the issue.

1.18 A green flag (ie the absence of a red or amber flag) does not necessarily indicate that no risk is present and similarly the fact that we are not specifically suggesting remedial action does not mean that scheme managers should not consider actions.

Limitations

1.19 We recognise that the use of data and models has limitations. For instance, the data that we have from valuation submissions and publicly available financial information is likely to be significantly less detailed than that available to funds. Our risk assessment framework is designed to broadly assess scheme risks and decide on our engagement with schemes on an indicative basis.

1.20 Because of the nature of this exercise, the only post-valuation events considered are those that may have already been taken into account in the valuation disclosures.





1.21 Further detail is provided in the solvency and long term cost efficiency chapters and appendices.

Exclusions

- 1.22 The Environment Agency Closed Pension Fund is different from other LGPS funds, in that the benefits payable and costs of the fund are met by Grant-in-Aid funding by the Department for Environment, Food and Rural Affairs³, guaranteeing the security of these benefits. South Yorkshire Passenger Transport Pension Fund's assets and liabilities have been transferred to the Greater Manchester Pension Fund, hence we have not considered the fund further. In general, these funds have been excluded from the analyses that follow.

The role of the actuary and other stakeholders

- 1.23 The following key has been used to identify the actuarial advisers for each fund:

-  Aon
-  Barnett Waddingham
-  Hymans Robertson
-  Mercer

- 1.24 Local valuation outputs depend on the local circumstances of each fund, the administering authorities' Funding Strategy Statements, and the actuary's work on the valuation.
- 1.25 We have reported where the review raised concerns in relation to the aims of section 13. In some cases these concerns are related to the particular circumstances of individual funds – for example mature funds that could have large liabilities relative to the financial resources of their employers have some inherent risks and may be more likely to be flagged under our 'asset shock' measure.

- 1.26 It is not our role to express an opinion as to whether any concerns raised are driven by the local circumstances of a fund, or the actions of authorities, their actuary, or other stakeholders. Nothing in this report should be taken as criticism of authorities, their actuary, or other stakeholders.

Data and assumptions

- 1.27 The metrics are based on publicly available data and data provided to GAD by or on behalf of administering authorities. Further details are in Appendix F.
- 1.28 To make meaningful comparison of valuation results, we have referred to results restated on two bases:
- the standard basis established by the SAB, as calculated by fund actuaries
 - a market consistent basis derived by us
- 1.29 Further details of both these bases are set out in Appendix G.
- 1.30 The market consistent basis is GAD's best estimate as at 2016, based on our views of likely future returns on each asset class across the Scheme. Future asset returns are uncertain and there is a wide range of reasonable views on what future asset returns will be and therefore the best estimate discount rates should be. We have presented GAD's view above, but there are other reasonable best estimate bases which may give materially different results.
- 1.31 This use of these standard bases does not imply the bases are suitable to be used for funding purposes:
- the SAB standard basis is not market consistent

³ <http://www.lgpsboard.org/images/Valuations2016/EAPFClosed2016.pdf>

- the market consistent basis is a best estimate (while regulations and CIPFA guidance call for prudence to be adopted). This best estimate is based on the average investment strategy for the overall scheme, and so will not be pertinent to any given fund's particular investment strategy. Further, this does not take into account any anticipated changes in investment strategy that may be planned or in train
- 1.32 The local valuations and our calculations underlying this report are based on specific sets of assumptions about the future. Some of our solvency measures are stress tests but these are not intended to indicate a worst case scenario.

Engagement with stakeholders

- 1.33 In preparing this report, we are grateful for helpful discussions with and cooperation from:
- MHCLG
 - fund administrators
 - actuarial advisors
 - LGPS Scheme Advisory Board
 - HMT
- 1.34 We note that this report is GAD's alone and the stakeholders above are not responsible for the content.
- 1.35 We are committed to preparing a section 13 report that makes practical recommendations to advance the aims in the legislation. We will continue to work with stakeholders to advance these aims and expect that our approach to section 13 will continue to evolve to reflect ever changing circumstances and feedback received.

Compliance and limitations

- 1.36 This work has been carried out in accordance with the applicable Technical Actuarial Standard: TAS 100 issued by the Financial Reporting Council (FRC). The FRC sets technical standards for actuarial work in the UK.
- 1.37 GAD has no liability to any person or third party for any act or omission taken, either in whole or in part, on the basis of this report. No decisions should be taken on the basis of this report alone without having received proper advice. GAD is not responsible for any such decisions taken.
- 1.38 We understand and assume that there is no regulatory authority assumed by or conferred on the Government Actuary in preparing this or any future section 13 report. In addition, the appointment to report under section 13 does not give the Government Actuary any statutory power to enforce actions on scheme managers (or others).



2 Compliance



Key compliance findings

- All reports checked contained a statement of compliance.
- All reports checked contained confirmation of each of the requirements in Regulation 62.
- We concluded that the aims of section 13 were achieved under the heading of compliance.

- 2.1 Section 13 requires that GAD must report on whether the actuarial valuations of the funds have been completed in accordance with the scheme regulations.
- 2.2 We found no concerns over compliance.
- 2.3 There is a great deal of consistency between the actuarial methodologies and the presentation of the actuarial valuation reports for funds that are advised by the same firm of actuarial advisors (see chapter on Consistency). Accordingly, GAD has selected one fund as a representative example from each of the firms of actuarial advisors, and has assessed whether these reports have been completed in accordance with Regulation 62.⁴
- 2.4 We found that the actuarial valuation reports for each of the above funds have been completed in accordance with Regulation 62, and have therefore concluded that the compliance criteria of section 13 have been achieved. We note that this is not a legal opinion.
- 2.5 Our review of compliance is focused on the actuarial valuation reports produced under Regulation 62. We have not, for example, systematically reviewed Funding Strategy Statements prepared under Regulation 58.
- 2.6 The comments we make in subsequent chapters on consistency, solvency and long term cost efficiency do not imply that we believe that the valuations are not compliant with the regulations. These comments relate only to whether the valuations appear to achieve the aims of section 13.

⁴ The statutory instrument governing the publication of actuarial valuations for the LGPS in England and Wales is Regulation 62 of the Local Government Pension Scheme Regulations 2013.



3

Consistency



Key consistency findings

- There has been an improvement in relation to disclosure of contribution rates.
- We recommend the SAB consider how best to implement a standard way of presenting relevant disclosures.
- The following assumptions show a marked difference for funds advised by the different firms of actuarial advisors that are not apparently due to local differences:
 - discount rate
 - mortality improvements
 - salary increases
 - commutation
- We recommend the SAB consider what steps should be taken to achieve greater clarity and consistency in actuarial assumptions, except where differences are justified by material local variations.
- We recommend the SAB seeks a common basis for future conversions to academy status.

3.1 Section 13 requires that GAD must report on whether the actuarial valuation has been carried out in a way which is not inconsistent with other valuations.

3.2 In this chapter we:

- provide some background on the legislation, and previous valuations
- discuss two types of consistency: presentational and evidential
- consider presentational consistency in more detail, looking in particular at the presentation of employer contribution rates and the analysis of the change in these rates since the previous valuation

- consider evidential consistency in more detail, looking first at liability values and then at various assumptions: discount rate, mortality improvements, salary increases and commutation assumptions
- conclude and make recommendations
- take a more detailed look the treatment of academies

Background: legislation and previous valuations

3.3 Section 13(4)(b) requires us to report on whether actuarial valuations have been carried out in a way which is not inconsistent with other valuations completed under the scheme regulations.

- 3.4 We consider how consistency relates to the ability to compare two actuarial valuation reports and draw appropriate conclusions. This relates to how key information is presented as well as whether the outcomes are able to be compared. We consider it is wholly appropriate for assumptions to be set relative to local conditions, but that this should be clearly explained and permit such comparisons to be made.
- 3.5 Note that Regulation 62 of the 2013 regulations does not include a requirement that the actuarial valuations are carried out in a way which is not inconsistent with other valuations completed under the scheme regulations. However, section 13 of the 2013 Act requires us to comment whether they have been carried out in this way.
- 3.6 We found improvements in consistency of contribution rate disclosure since the dry run. This was a major concern at the time. We welcome this significant progress. However, we found some other aspects of consistency had not improved since the dry run. Some aspects of this are discussed below.

Presentational and evidential consistency

- 3.7 Readers of the actuarial valuations face two difficulties in making meaningful comparisons between the reports:
- Presentational: information may be presented in different ways in different reports (eg funding levels), and sometimes information is contained in some reports but not others (eg life expectancies), so readers may have some difficulties in locating the information they wish to compare. We call this presentational inconsistency.
 - Evidential: even when the reader has located the relevant information (eg funding levels), differences in the underlying methodology and assumptions mean that it is not possible to make a like for like comparison. We call this evidential inconsistency. We believe that local circumstances may merit different assumptions (eg financial assumptions are affected by the current and future planned investment strategy, different financial circumstances leading to different levels of prudence adopted). However, in some areas, it appears that the choice of assumptions is highly dependent on the house view of the particular firm of actuaries advising the fund, with only limited evidence of allowance for local circumstances.
- 3.8 Under both aspects there is a great deal of consistency when comparing any two reports produced by the same firm of actuarial advisors, but comparisons between reports of different firms of actuaries are more difficult.

Presentational consistency

- 3.9 We have taken a report produced by each firm of actuarial advisors to assess whether the information disclosed is consistent across all four advisors. The chosen funds are:
- Merseyside Pension Fund: Mercer
 - London Borough of Haringey Pension Fund: Hymans Robertson
 - Hampshire County Council Pension Fund: Aon
 - Royal County of Berkshire Pension Fund: Barnett Waddingham
- 3.10 All four funds provide most of the key information that we expected from an actuarial valuation report. Each report also contains a section that summarises the changes to the funding position since the 2013 reports, and these are presented in very similar ways making for easy comparison.

3.11 However, the whole fund secondary contribution rates were not presented consistently, which might cause user difficulties if they wished to make comparisons between funds. This is discussed in more detail below.

Contribution rates

3.12 Contribution rates include the following components:

- primary contribution rate
- secondary contribution rate
- member contribution rate

3.13 The primary contribution rates are easily found in the valuation reports for each fund, and, as they are all expressed as a percentage of pay, are easily comparable. The same is true of member contribution rates.

3.14 Secondary contribution rates are more complex and the whole fund rates are not

presented consistently in the valuation reports. All firms of actuarial advisors provide a detailed breakdown of the secondary contribution rates by employer for each of the next three years in their Rates and Adjustments Certificates. However, the summary statistics provided for the funds as a whole varied significantly between firms of actuarial advisors.

3.15 Table 3.1 summarises the information with regard to secondary contribution rates that are given in the valuation reports for the different firms of actuarial advisors. The inconsistent presentation of the secondary contribution rates relates to the presentation of the whole of fund / aggregate secondary contribution rates rather than individual employer secondary contribution rates. To aid comparison of these rates it would be helpful to present them more consistently. Given funds are of different sizes, translating whole fund secondary rates into a percentage of pensionable pay would assist.

Table 3.1: Secondary contribution rates

Fund (Firm of actuarial advisors)	2017	2018	2019	Average for recovery period
Hampshire (Aon)	£75,680,400 less 2.9% of pensionable pay	£81,548,300 less 1.9% of pensionable pay	£87,248,800 less 0.9% of pensionable pay	7.5% of pensionable pay
Berkshire (Barnett Waddingham)	£21,017,000 or 5.3% of pensionable pay	£27,468,000 or 6.7% of pensionable pay	£34,075,000 or 8.2% of pensionable pay	7.7% of pensionable pay
Haringey (Hymans Robertson)	£9,252,000	£8,612,000	£9,554,000	-
Merseyside (Mercer)	£136,300,000 less 0.9% of pensionable pay	£52,500,000 less 0.4% of pensionable pay	£53,600,000 plus 0.1% of pensionable pay	-

- 3.16 Barnett Waddingham expressed the secondary contribution rate as a percentage of pay and also gave the equivalent monetary amount. Aon and Mercer expressed the secondary contribution rate as a combination of a monetary amount and a (negative) percentage of pay. Hymans Robertson gave a monetary amount only.
- 3.17 Aon and Barnett Waddingham gave a single headline figure that summarises the average secondary contribution rate over the entire deficit recovery period for that fund.
- 3.18 In our view, the 2016 reports represent an improvement in the consistency of disclosures compared to those in the 2013 reports. Nevertheless, presentational inconsistency makes it difficult to compare the funds from all four firms of actuarial advisors based on the information provided in the valuation reports, without performing further analysis.

Change in contribution rates since the previous valuation

- 3.19 We note that regulations have changed with common contributions being replaced by primary and secondary contribution rates for employers. This makes comparison with the previous valuation difficult. Ideally, in future, we would expect to see a comparison of recommended primary and secondary contribution rates with those from the previous valuation. Table 3.2 shows the comparisons provided in each of the four reports.
- 3.20 A comparison with aggregate employer rates is provided in some cases. Others provide a comparison of primary rates only. We believe such a comparison is useful to enable the reader to understand the total level of contributions being paid into the fund.

Table 3.2: Comparison with prior valuation contribution rates

Fund	Comparison provided
Hampshire (Aon)	Comparison of the aggregate employer total contribution rate
Berkshire (Barnett Waddingham)	Analysis of the change in primary contribution rates, but no comparison of total employer rates
Haringey (Hymans Robertson)	The 2013 common contribution rate ⁵ alongside a comment that the change in regulatory regime and guidance on contribution rates means that a direct comparison to the whole fund rate at 2016 is not appropriate
Merseyside (Mercer)	Breakdown of the primary employer contribution rate compared with the previous valuation

⁵ The common contribution rate (CCR) has been replaced by primary and secondary contribution rates in legislation. In some cases the CCR bore no relationship to actual contributions paid by employers.

Evidential consistency

3.21 We have considered whether the local fund valuations have been carried out in a way which is not inconsistent with each other. We have not found any significant inconsistencies in the results of the valuations (the recommended employer contribution rates), but there are significant inconsistencies in the assumptions adopted.

3.22 Inconsistencies in the methodology and assumptions are less critical than inconsistencies in the results would be. However these inconsistencies make it difficult for users to compare reports, and in our view do not serve any clear purpose. We therefore make a recommendation below that the SAB consider this issue.

3.23 In the paragraphs that follow we:

- look at the range of difference in the value assigned to the liabilities between the local basis and the standard SAB basis, which illustrates the impact of inconsistencies in the local bases

- consider some specific assumptions in detail (including the discount rate), to illustrate the apparent inconsistencies

Value assigned to the liabilities

3.24 The value assigned to liabilities in each actuarial valuation report has been calculated on assumptions set locally. Differing levels of prudence are to be expected and may be reflective of local variations in risk appetite, but care needs to be taken when comparing results.

3.25 Table 3.4 shows a comparison of local basis liability values vs SAB basis liability values, and charts B1 and B2 in Appendix B shows a comparison of local funding levels vs SAB basis funding levels, which illustrate the variation in levels of prudence adopted in each valuation, and therefore the difficulty in drawing conclusions based on liability values.

3.26 The liability value on the local basis for Berkshire is lower than on the SAB standard basis, yet the reverse is true for the other three funds. Across the whole Scheme, the range is between 36% and -1%. This illustrates the difficulty for the reader in drawing comparisons between reports.

Table 3.3: Liability values

Fund	Local basis £m	SAB standard basis £m	Difference between local basis and SAB standard basis
Hampshire (Aon)	6,453	5,718	13%
Berkshire (Barnett Waddingham)	2,242	2,267	-1%
Haringey (Hymans Robertson)	1,323	1,118	18%
Merseyside (Mercer)	8,081	7,019	15%

Assumptions adopted

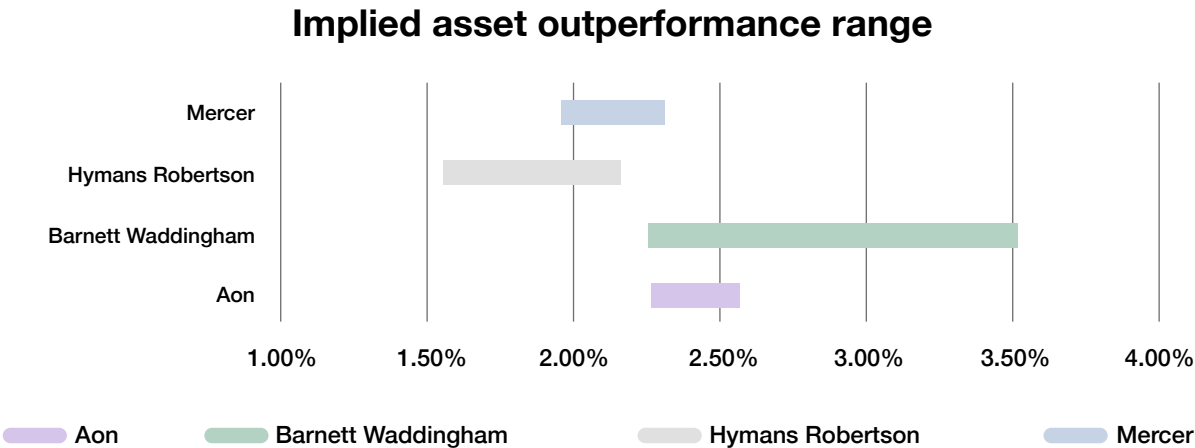
3.27 We compared the following key assumptions that need to be made for the actuarial valuations for all funds to consider whether variations in those assumptions are justified in terms of local conditions:

- discount rate
- mortality improvements
- salary increases
- commutation rates

Discount rates

3.28 A way of measuring the level of prudence built into the pre-retirement discount rate used to assess past service liability is by considering the implied asset outperformance within the discount rate (the implied real return above the risk free return within the discount rate) (see Appendix B.8 for more details). Note this applies to all assets, not just ‘return seeking’ assets. The following chart illustrates implied asset outperformance ranges within the discount rate used to assess past service liability⁶, by firm of actuarial advisors.

Chart 3.1: Implied asset outperformance



⁶ Note that some funds use different discount rates to assess past service liabilities and future service contribution rates, we consider only the former here.

3.29 We would expect some fund-by-fund variation due to asset strategy and different levels of risk appetite. Therefore we do not consider the fact that funds adopt different discount rates to be a particular cause for concern. Future asset returns are highly uncertain, and so there is a wide range of reasonable assumptions that may be adopted.

3.30 We are not stating that any particular set of assumptions adopted is not reasonable. However it does appear that they are not consistent with each other.

3.31 Chart 3.1 illustrates one aspect of this difference in assumptions applied by the four firms of actuarial advisors. The funds advised by Hymans Robertson tended to show the lowest level of asset outperformance within the discount rate. Those advised by Mercer sit in the middle of the range, and the funds advised by Aon and Barnett Waddingham have the highest level of outperformance within the discount rate used for assessing past service liability values.⁷

3.32 We might expect less bunching by firm of actuarial advisors if discount rates were set according to local conditions. The discount rate chosen appears to depend on the choice of firm of actuarial advisors. In this regard, we consider the aim of section 13 under consistency may not be achieved.

3.33 We acknowledge, given there are multiple funds advised by four different actuarial advisors, that there is difficulty ensuring consistency of methodologies and assumptions used. This, in conjunction with adequate disclosure in the reports, should allow comparison by a reader of the reports. Consistency is, however, one of the four aims of section 13 and we consider that to improve consistency, stakeholders should work together to overcome some of these difficulties.

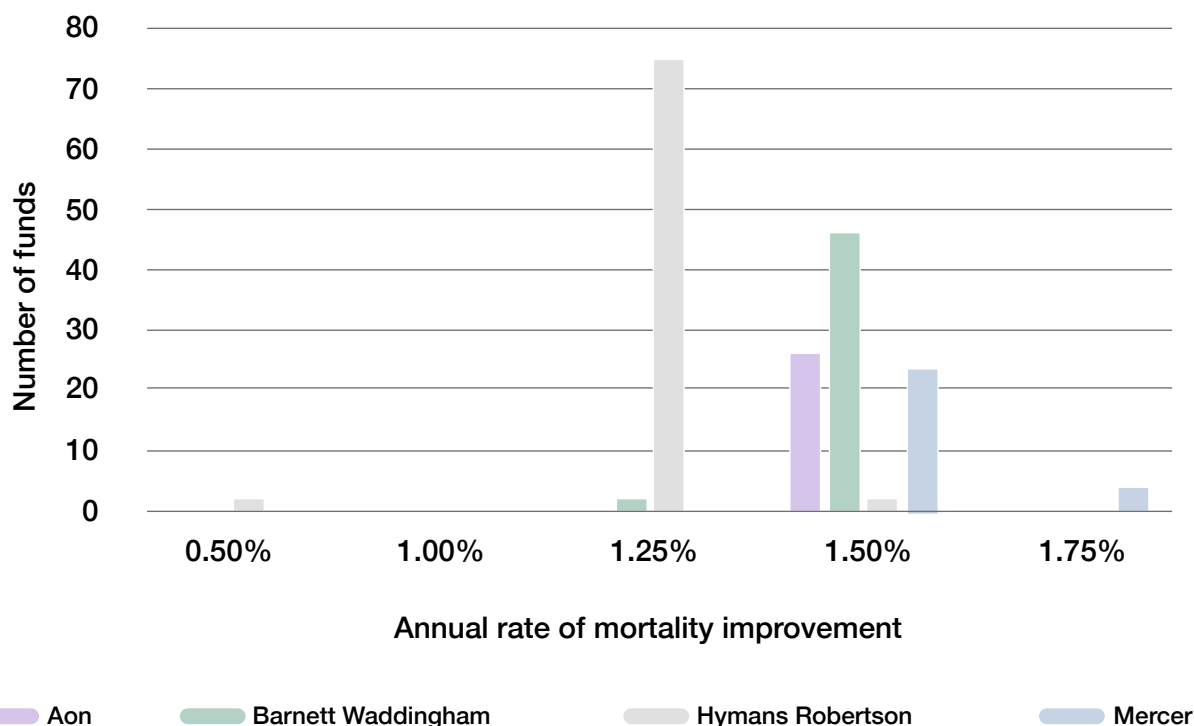
Mortality improvements

3.34 The mortality assumption is a function of current (or base) mortality and expectations for future improvements. It is reasonable to set the base mortality assumption on local data. However, mortality improvements must be based on a projection, such as the Institute and Faculty of Actuaries' CMI projections⁸ with an assumed rate of future increases counted separately. The assumed long term rates of future mortality improvements for males and females are summarised in Chart 3.2 below:

⁷ The asset outperformance in Chart 3.1 relates to the discount rate for past service liabilities only. For setting future service contribution rates, Hymans Robertson use a stochastic approach. Mercer follow a deterministic method, but add eg 0.5% to the discount rate for setting contribution rates.

⁸ <https://www.actuaries.org.uk/learn-and-develop/continuous-mortality-investigation/cmi-investigations/mortality-projections>

Chart 3.2: Mortality improvements assumptions for males and females



3.35 Hymans Robertson tends to assume a rate of mortality improvement 0.25% lower than that of the three other firms of actuarial advisors. Hymans Robertson also use an earlier mortality improvements model. The other three firms of actuarial advisors used higher improvement rates and based their mortality improvements on more recent projections. This is understandable because it is difficult to assess future mortality trends, and during the period up to 2016 there was considerable uncertainty in the direction of these trends. The assumption adopted by each fund appears to be heavily influenced by the advisor rather than any local considerations. Each assumption falls within an acceptable range, but we consider it would be helpful if the four firms adopted a consistent assumption for this item.

Salary increases and commutation assumptions

- 3.36 The rate of promotional pay increases and commutation (the extent to which members on average exchange pension in favour of a tax free cash benefit) assumptions appear in the case of some of the firms of actuarial advisors to be set as a house view rather than an approach clearly based on local conditions. Charts B5 and B6 in Appendix B illustrate this.
- 3.37 Most firms of actuarial advisors confirmed they perform some analysis under both these areas. In some cases this appears to result not in local variation, but rather an average assumption across the funds under a given advisor. The firms of actuarial advisors cite lack of materiality in some cases, which we consider reasonable. However, in these cases, we believe it would be helpful to use a common assumption across all funds to aid comparability.

Conclusion and recommendations

3.38 Section 13 requires valuations to be carried out in a way that is not inconsistent with other LGPS fund valuations. We interpret this in a presentational and evidential way. We consider the criterion has not been achieved if a user is not able to draw comparisons between the results from two valuation reports.

3.39 Stakeholders may wish to set out objectives for a possible project to improve consistency to help readers to understand the prudence being used in the report with regard to both past service liabilities and aggregate contribution rates. These objectives may include:

- a framework for relevant assumptions to be set by local government collectively
- recognition that, where appropriate, assumptions should be set according to local conditions, following review of local experience and discussion with relevant stakeholders
- assumptions should be set consistently, in that different assumptions should be clearly justified by specific local circumstances (eg different asset strategies, different risk appetites, different local mortality experience)

3.40 Examples of where the criterion may not have been achieved include:

- some remaining inconsistency in reporting of whole of fund secondary contribution rates

- assumptions with a marked difference for funds advised by the different firms of actuarial advisors that cannot be justified by local differences:

- mortality improvements
- discount rate
- salary increases
- commutation

3.41 These differences contribute, alongside genuine local variations, to differences between funding levels and recommended contribution rates on local bases which a reader may find it difficult to interpret without undertaking further analysis.

Recommendation 1: We recommend that the Scheme Advisory Board should consider how best to implement a standard way of presenting relevant disclosures in all valuation reports to better facilitate comparison, with a view to making a recommendation to the MHCLG minister in advance of the next valuation. We have included a draft dashboard in this report to facilitate the Scheme Advisory Board's consultation with stakeholders.

3.42 We set out a possible dashboard to facilitate the Scheme Advisory Board's consultation with stakeholders. Such a dashboard could facilitate comparison both between funds and between successive valuations of the same fund.

Table 3.4: Possible dashboard for inclusion in valuation reports

Item	Proposed format
Funding level (assets/liabilities)	%
Funding level (change since previous valuation)	%
Market value of sssets	£m
Value of liabilities	£m
Surplus (deficit)	£m
Deficit recovery end point	year
Change in deficit recovery end point	+/- number of years
Primary contribution rate (average for the fund)	£ pa, % of pay
Secondary contribution rate (average for the fund)	£ pa, % of pay
Total employer rate (average for the fund)	£ pa, % of pay
Total employer rate (change since previous valuation)	£ pa, % of pay
Employee contribution rate	£ pa, % of pay
Discount rate(s)	% pa
Assumed pension increases (CPI)	% pa
Method of derivation of discount rate, plus any changes since previous valuation	Freeform text
Life expectancy for current pensioners – men age 65	years
Life expectancy for current pensioners – women age 65	years
Life expectancy for future pensioners – men age 45	years
Life expectancy for future pensioners – women age 45	years
Funding level on SAB basis (for comparison purposes only)	Simple overall percentage

3.43 We note that such a dashboard would facilitate comparison between funds, but should not be translated into funding advice.

Recommendation 2: We recommend that the Scheme Advisory Board should consider what steps should be taken to achieve greater clarity and consistency in actuarial assumptions, except where differences are justified by material local variations, with a view to making a recommendation to the MHCLG minister in advance of the next valuation.

Academies

- 3.44 MHCLG has asked GAD to review academy contribution rates under the heading of consistency, following recent work led by the SAB.
- 3.45 We conducted our investigation based on data provided by the firms of actuarial advisors in order to understand how academies are being treated in the LGPS. The outcomes of this investigation are summarised below.
- 3.46 The SAB has identified two work-streams – administration and funding – and plans to complete its work and make recommendations to ministers later this year.

GAD's investigations

- 3.47 GAD's report is published [here](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/740947/Academies_analysis_report_final.pdf).⁹
- 3.48 The analysis concluded that:
- on average academies currently pay 2% of payroll less in contributions than local authorities (LAs) (21% on average for academies, 23% on average for local authorities)
 - there is a high degree of variability in individual contribution rates
 - academies are treated consistently with LAs, suggesting that the DfE guarantee is currently being recognised by funds
 - given the existing approach for setting academy contribution rates, we would expect (material) nationwide variation between individual academy contribution rates and LA contribution rates to persist in future. Further, the extent of the variation observed at the 2016 valuation could potentially increase, particularly if there is a large increase in the number of new academies

Conclusions and recommendations

- 3.49 We concluded that, on average, academies were treated fairly in relation to LA employers, but there was considerable inconsistency in methods adopted for allocating initial assets to the academies, and in some cases the period for repaying initial deficits, and this has contributed to a wide range of contribution rates paid by academies.
- 3.50 Two streams are being pursued by the SAB:
- administration stream: we support the work of the SAB in seeking to simplify and streamline administration processes, noting that these improvements are not just relevant to academies, but to all employer groups
 - funding stream
- 3.51 One area that can improve consistency of treatment between academies is the allocation of assets upon conversion to academy status. Consistency in the basis adopted at conversion, in particular for allocation of assets between the academy and the fund, and for the deficit recovery period, will help provide clarity to multi academy trusts about the costs associated with conversion.

Recommendation 3: We recommend that the Scheme Advisory Board seeks a common basis for future conversions to academy status that treat future academies more consistently, with a view to making a recommendation to the MHCLG minister in advance of the next valuation.

⁹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/740947/Academies_analysis_report_final.pdf



4

Solvency



Key solvency findings

- Most funds in the LGPS meet the conditions required to be able to demonstrate solvency and in general funding levels have improved significantly across the scheme since the dry run.
- In total, 74 out of 89 funds tested had green flags on all solvency measures, an improvement since the dry run (56 out of 90).
- We have highlighted a number of funds where substantial contribution increases may need to be absorbed. Although we did not conclude that the aims of section 13 were not achieved, we believe fund managers should be aware of this risk.
- We recommend that West Midlands Integrated Transport Authority Pension Fund puts a plan into place to ensure the fund is able to continue to meet benefits in the event that no future contributions are available.

4.1 Under section 13(4)(c) of the Act, the Government Actuary must report on whether the rate of employer contributions to the fund is set at an appropriate level to ensure the solvency¹⁰ of the pension fund.

4.2 In this chapter we:

- provide a definition of solvency
- provide some background on solvency issues, and the measures and flags we have used in considering them
- consider the potential volatility of contributions through an asset liability study
- set out flagged solvency risks for open funds

- discuss the solvency risks for West Midlands Integrated Transport Authority, which is a closed fund

Definition of solvency

4.3 We do not regard that solvency means that a pension fund should be 100% funded at all times. Rather, in line with the definition in CIPFA's Funding Strategy Statement guidance¹¹ which we adopt for the purposes of section 13, we consider that the rate of employer contributions has been set at an appropriate level to ensure solvency of the pension fund if:

- the rate of employer contributions is set to target a funding level for the whole fund (assets divided by liabilities) of 100% over

¹⁰ The explanatory notes to the Act state that solvency means that the rate of employer contributions should be set at "such a level as to ensure that the scheme's liabilities can be met as they arise".

¹¹ <http://www.cipfa.org/policy-and-guidance/publications/p/preparing-and-maintaining-a-funding-strategy-statement-in-the-lgps-2016-edition>

an appropriate time period and using appropriate actuarial assumptions

and either:

- employers collectively have the financial capacity to increase employer contributions, and/or the fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%

or

- there is an appropriate plan in place should there be, or there is expected in future to be, no or a limited number of fund employers and/or a material reduction in the capacity of fund employers to increase contributions as might be needed

Background on solvency

- 4.4 Most funds have improved their funding level since the 2013 valuations. For example, on GAD's best estimate basis, the aggregate funding level across all LGPS funds at 2016 had improved from around 93% to approximately 106%, and around 60 funds were in surplus on this basis. This means that we expect, on average, there is a greater than 50% chance that existing assets would be sufficient to cover benefits in respect of accrued service when they fall due.
- 4.5 In the case of tax-raising employers, accommodating contribution variability is a political, as well as financial, consideration. We consider it is important that administering authorities and other employers understand the potential range of future cost, so that they can understand the affordability of potential future contribution requirements.
- 4.6 We have performed some asset liability modelling work to help illustrate the potential for variation in contribution rates that may be required if foreseeable variations to market conditions were to occur.

4.7 We have assessed risk against a range of measures and have highlighted funds where we believe specific risk is present. These are risks of potential contribution volatility that managers should be aware of. Managers should consider actions required to manage these risks, but accepting the risk may be a valid option. The flag does not imply that anything has gone wrong and maintaining the flag does not imply that we take issue with any decision to accept the risk. The amber flag is an indication that the risk is accepted or has not been mitigated – it is not implying that the administering authority is unaware of the risk.

4.8 All funds should be aware of their solvency position, to ensure that the relevant plans are in place to be able to pay benefits when they fall due and employers are able to accommodate potential future increases in contributions.

4.9 This is particularly important in the case of mature funds, where volatility of contributions may be greater. In particular, they should ensure that sufficient plans are in place to be able to pay benefits when they fall due in the potential environment of no future employer contributions.

4.10 We note that, in total, 74 out of 89 funds had green flags on all solvency measures, a significant improvement since the dry run (56 out of 90).

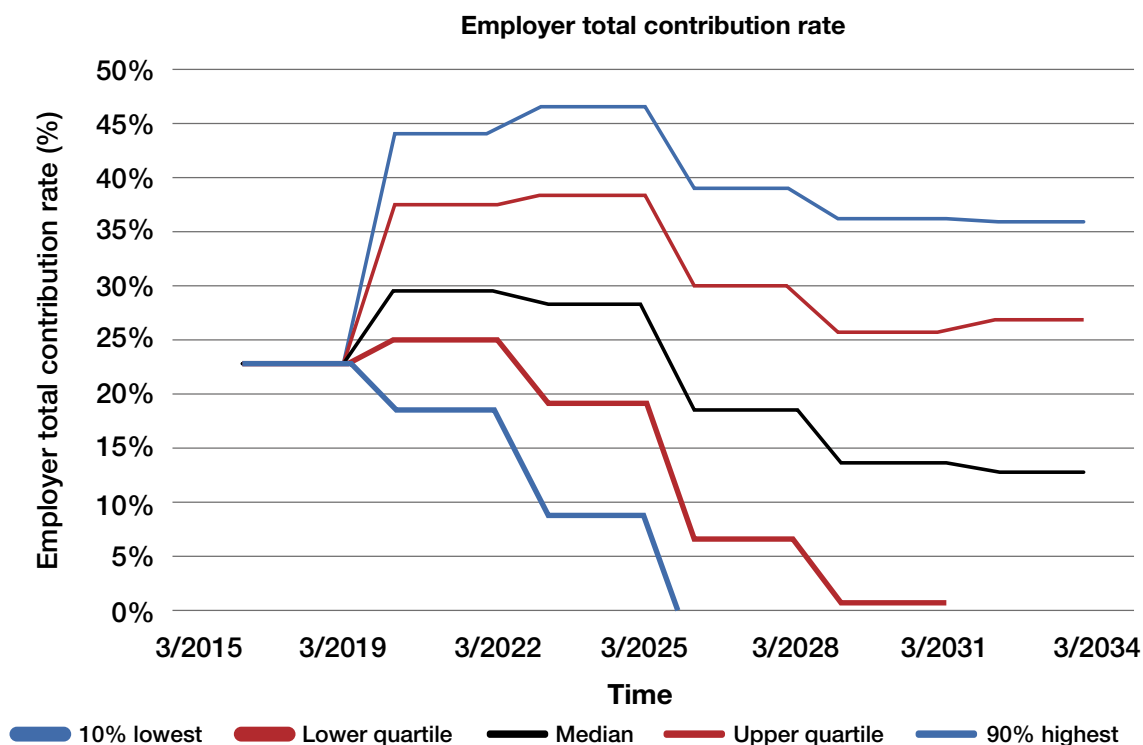
4.11 Flagged measures in this report include:

- SAB funding level, where we have highlighted as a risk to be aware of the ten open funds with the lowest figures. This is a purely relative, existing risk
- asset shock, where we have highlighted four funds that could be required to absorb a large increase in contribution rates (relative to core spending power for all but one fund) should a significant, sustained shock occur

Volatility of contributions: asset liability study

- 4.12 Volatility of asset returns and changes in economic conditions may place significant pressures on the future rate of employer contributions.
- 4.13 We performed an asset liability study to investigate and help quantify these pressures. The asset liability study provides a simultaneous projection of the assets and liabilities of the scheme under a large number of stochastic economic scenarios to demonstrate potential funding and hence contribution outcomes of the scheme under different potential circumstances.
- 4.14 For the purpose of assessing liabilities and determining contributions, assumptions are needed on what set of assumptions will be used to carry out an actuarial valuation at each future point in time being considered. In our modelling we have assumed that:
- changes to the financial assumptions will reflect market conditions at the valuation date (specifically, long term gilt yields)
 - the length of the recovery period is fixed at 20 years at each valuation to approximate what funds are doing in practice
- 4.15 The output of the model is the upwards or downward pressure on contribution rates assuming that the impact of changes in economic conditions feeds through directly to contribution setting.
- 4.16 In practice we might not expect these pressures to feed directly into changes in employer contribution rates, because for example, if there was a downward (or upward) cost pressure the following adjustments might be considered:
- asset strategy might be made more defensive which would be expected to reduce future volatility but would reduce the scope for reducing contributions (conversely,
- if there was an upward cost pressure, the asset strategy might be made more return seeking)
- the length of the recovery period might be reduced (conversely, if there was an upward cost pressure, the length of the recovery period might be increased)
 - the level of prudence might be increased, which could reduce the chance that future experience was worse than assumptions, but could also limit the scope for reducing contributions (conversely, if there was an upward cost pressure, the level of prudence might be reduced)
- 4.17 The output of the model should not therefore be regarded as predictions of changes in future employer contribution rates, but rather the potential pressures on the employer contribution rate that might need to be managed in some way. Any changes to manage down employer contribution rates in the short term do not alter the long term cost of the scheme (which depends on the level of scheme benefits and scheme experience, including asset returns) and more generally might have some other less desirable outcomes, for example:
- increasing the length of recovery periods transfers costs onto future generations
 - choosing a more return seeking asset strategy would be expected to increase volatility and risk

Chart 4.1 Range of employer total contribution rate



4.18 Chart 4.1 illustrates the potential upward or downward pressures on employer contribution rates. The black line represents the median¹² expected outcome, the red lines the 25th and 75th percentile¹³ outcomes and the blue lines the 10th and 90th percentile outcomes.

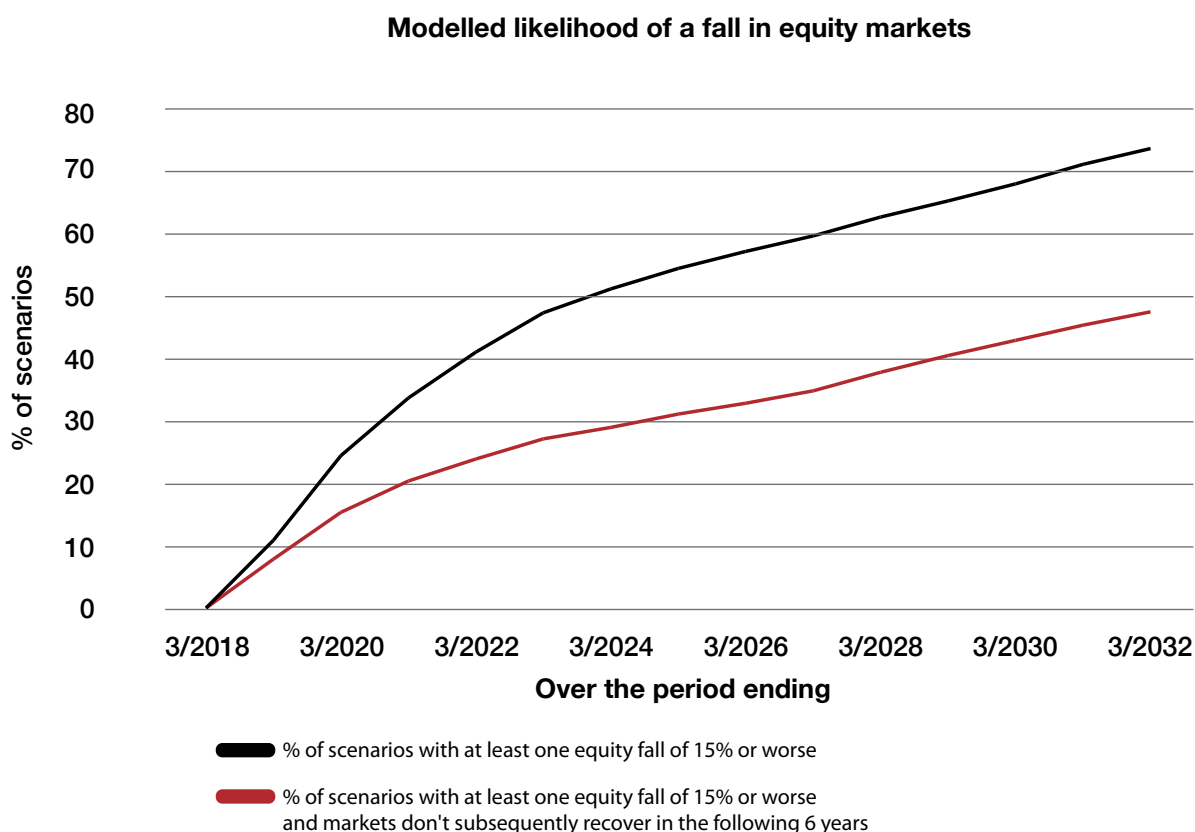
4.19 Chart 4.2 illustrates the cumulative risk¹⁴ that equity markets fall over 12 months by more than 15% at some point over the next 20 years, and the chances of those markets not recovering within two valuation cycles. This indicates the scenario envisaged in our asset shock measure is plausible.

¹² The median is the central outcome of the range, which means, according to the model, the actual outcome is equally likely to be higher or lower than the median. Note that the median is the middle outcome at each point in time. The median line does not represent a prediction of outcomes.

¹³ The 25th and 75th percentile outcomes represent the outcomes where there is a one in four chance the outcome will be more extreme in the relevant direction. For the 10th and 90th percentile outcomes, there is a 10% chance of a more extreme outcome.

¹⁴ This is an output from our model, which itself is dependent on assumptions/economic scenario generator underlying that model, for example in relation to equity market mean reversion. Different models will produce different outcomes. Our model assumes discount rates are driven from underlying gilt yields with a variable equity outperformance assumption.

Chart 4.2 Modelled likelihood of a fall in equity markets



Key message

4.20 It is highly likely that there are significant developments between each valuation that could result in relatively large pressures on employer contribution rates. In particular, after removing potential trends in the projected future contribution rate, we estimate that, based on economic circumstances alone, there is around a 30% chance of an upward pressure of 8% of pay or more and a 30% chance of a downward pressure of 8% of pay or more. This should not be regarded as a prediction of the changes in future employer contribution rates, because adjustments might be made to manage such pressures as discussed above.

4.21 In addition to the key message above, the asset liability study provides further illustration of possible changes in contribution rates.

- **In the short term, there may be upwards pressure on employer contributions at the next valuation cycle.**

This primarily reflects the modelled reduction in valuation discount rates, relative to the last valuation – as a result of falling gilt yields although this is mitigated by strong asset returns since 2016. In practice, the upward pressure on contributions may be further managed (perhaps to the point that upward pressures are relieved) if valuation discount rates (relative to gilt yields) increase or by other changes.

- **In the medium to longer term, employer contributions are expected to fall, such that they are expected to be lower than current contribution levels.**

This reflects reducing deficit repair contributions and expected asset outperformance from growth assets. Depending on the assumptions made about future gilt yields and return expectations, there may also be increases in valuation discount rates which further ease contribution pressures.

- **There remains a risk that contributions are materially higher than current levels.**

There is still a significant chance that economic assumptions and factors do not turn out as expected and contribute to a deterioration in the scheme's funding position or cost of accrual that lead to significant upward pressure on employer contributions.

- 4.22 These messages are illustrated in charts in Appendix E which shows the median and outer percentile results of this exercise. Employer total contributions include the cost of ongoing benefit accrual and deficit recovery contributions where appropriate, less member contributions, aggregated across all funds.

Solvency risks for open funds

- 4.23 In the following tables we illustrate the results of the solvency measures we have used for each of the individual funds in the LGPS where at least one measure of solvency was amber or red. In Appendix C (Table C1) we set out the considerations with regards to risks already present and emerging risks, and map these to the measures we have adopted for this exercise.

SAB funding level

- 4.24 The SAB basis is a useful measure to compare the relative funding position of each fund, but it is not a market related basis, and is therefore not directly appropriate for funding purposes. Our definition of solvency does not require a fund to be 100% funded on any given basis at all times. Rather, this measure gives an indication of the extent of remedial action that may be required to ensure solvency. Long term cost efficiency measures are designed to check whether funds are taking suitable steps to improve the level of funding. Table 4.1 outlines those funds in the lowest decile for funding level (the measure is the distance from the average funding level).
- 4.25 We have engaged with the funds with the lowest SAB funding levels. Most have indicated they have plans to improve funding levels over time, by paying increased deficit contributions. Brent, in particular, indicated that their long term budgeting process allows for these expected contributions over the full term of the expected deficit recovery period, which we acknowledge. If other funds set similar long term budgets this would help to demonstrate solvency. In our engagement with Worcestershire Pension Fund, the administering authority highlighted that their funding position has increased significantly and that their strategy for investments now includes equity protection. This was adopted during early 2018 and runs past the next actuarial revaluation. The fund is assessing its investment strategy and risk appetite also before the next valuation.

Table 4.1 – Funds with an amber flag on SAB funding level

Pension fund	SAB funding level distance from mean
Bedfordshire Pension Fund	-13%
City of London Corporation Pension Fund	-11%
London Borough of Barnet Pension Fund	-13%
London Borough of Brent Pension Fund	-29%
London Borough of Croydon Pension Fund	-15%
London Borough of Havering Pension Fund	-17%
London Borough of Waltham Forest Pension Fund	-19%
Royal County of Berkshire Pension Fund	-23%
Somerset County Council Pension Fund	-15%
Worcestershire County Council Pension Fund	-11%

Asset shock

- 4.26 We have performed a series of tests in relation to emerging risks. These are stress tests in relation to what may happen if certain events occur. Asset shock considers the scenario of a sustained reduction in the value of return seeking assets. For example, this could be a market correction in which asset values do not immediately recover, and therefore cannot be absorbed by a change in assumptions. In this scenario we model the additional contributions that would be required to meet the emerging deficit (as opposed to the total contributions required following the shock). We are looking at where there is a risk of large changes to the contribution rate, rather than a risk of the total contribution rate exceeding some threshold.
- 4.27 We consider these additional contributions in the context of the financial resources of the underlying statutory employers, for which we have used core spending power¹⁵, as a proxy as advised by MHCLG. A shock which generates high additional contributions as a

proportion of core spending power generates a flag, as this may indicate that the local authority may be less likely to be able to absorb substantial contribution increases without affecting core services. Funds with a high level of return seeking assets (whether due to a high funding level or their strategic asset allocation between return seeking and defensive) are more exposed to asset shocks and more likely to trigger this flag. More detail is given in Appendix C. We note core spending power does not represent all sources of income for all local authorities.

- 4.28 The funds in table 4.2 have generated an amber flag for the asset shock. We consider that an asset shock flag, on its own, does not imply that the aims of section 13 are not achieved, and so do not recommend immediate remedial action. Rather, we believe this may indicate some risk in relation to solvency that fund managers should be aware of and monitor over time.

¹⁵ See definition in Appendix C

4.29 We also developed two other stress tests:

- liability shock (in which we consider the impact of an increased liability value as a result of sustained lower interest rates)
- employer default shock (in which non-statutory employers are assumed to default on their pension liabilities, so their deficit transfers to remaining employers)

In practice we considered that the liability shock was not independent of the asset shock and few funds triggered the employer default shock, so we have opted not to highlight the results in this report.

Asset shock - specific engagement outcomes

4.30 We note that, with the exception of London Pensions Fund Authority, the other three amber flags relate to metropolitan funds. The main driver for this is the fact that the pension liabilities for the metropolitan funds are relatively high compared with their core spending power, rather than differences in asset strategies. Further analysis would be required to determine whether there is a different relationship between core spending power and other financial resources in the metropolitan funds, compared with non-metropolitan funds.

Table 4.2 – Funds with an amber flag on asset shock

Pension fund	Asset shock increase in contributions as a % of CSP
South Yorkshire Pension Fund	3.0%
Tyne and Wear Pension Fund	3.5%
West Yorkshire Pension Fund	3.7%
London Pensions Fund Authority Pension Fund	Amber

South Yorkshire Pension Fund

- 4.31 In our engagement with South Yorkshire Pension Fund, the administering authority highlighted that their investment now includes equity protection, which is intended to protect against falls in equity markets of between 5 and 30% over two years, while giving up gains above 14.25%. As such, if the strategy works as intended this will insulate the fund against the sort of major shocks we have modelled. This strategy was implemented during 2018.
- 4.32 This form of equity protection may be a suitable approach to protecting against shocks in the market. We make some brief comments about the operation of this strategy in Appendix C, however we do not comment on the effectiveness of this strategy.
- 4.33 We welcome the fact that South Yorkshire Pension Fund in consultation with the fund's employers has recognised that a risk does exist, and has reviewed the options available, and taken positive action. We maintained the asset shock flag for this report, because it the strategy was implemented after the 2016 valuation date. But if it remains in place, we will do further analysis in the next section 13 report.

London Pensions Fund Authority Pension Fund

- 4.34 LPFA is a special case as it has no core spending power and is a fund with primarily legacy liabilities. In the case of LPFA, the asset shock flag indicates a risk of a significant increase in contribution rate expressed as a percentage of pensionable pay. We engaged with LPFA. They considered pensionable pay as an incomplete representation of their ability to meet contribution variation. We intend to continue to engage with LPFA at the next section 13 exercise to further understand their particular circumstances.

Tyne and Wear Pension Fund, West Yorkshire Pension Fund

- 4.35 We engaged with both funds. They each considered core spending power as an incomplete representation of their ability to meet contribution variation.

Closed Funds: West Midlands Integrated Transport Authority

- 4.36 Funds that are closed to new members typically have decreasing payrolls, and funds which may be large relative to that payroll. This may lead to reduced scope to be able to meet variations in contributions. This in turn means that they may require outside funding in the future, which in turn may be uncertain, for example if there is no specific commitment from a guarantor.
- 4.37 The Environment Agency Closed Pension Fund has been excluded from the analyses in this report as the benefits payable and costs of the fund are met by Grant-in-Aid funding by the Department for Environment, Food and Rural Affairs as set out in the Compliance chapter.
- 4.38 South Yorkshire Passenger Transport Pension Fund's assets and liabilities have been transferred to the Greater Manchester Pension Fund, hence we have not considered the fund further.
- 4.39 West Midlands Integrated Transport Authority Pension Fund (WMITA) is the only remaining fund that is closed to new members and fully private sector backed. Tables 4.4 and 4.5 set out the red flags generated by WMITA.

Table 4.3 – Closed funds with an amber or red flag on open fund measure

Pension fund	Open fund
West Midlands Integrated Transport Authority Pension Fund	No

Table 4.4 – Closed funds with an amber or red flag on non-statutory employees

Pension fund	Non-statutory employees
West Midlands Integrated Transport Authority Pension Fund	100%

Specific engagement outcomes

- 4.40 Heightened employer covenant risk from the two non-statutory employers in this fund has been mitigated in part through guarantee arrangements, which provide some (albeit limited) additional financial capacity.
- 4.41 It is a relatively small fund, with total assets of around £500m.
- 4.42 If the employers were operating in a private sector pension scheme, PPF protection to members' benefits would apply. However, PPF protection does not apply to LGPS funds.
- 4.43 We consider two scenarios in which the solvency of the fund may be at risk:
- if the existing employers both exited the funds (by meeting the exit requirements under Regulation 64), there would be no fall-back in the event that the funds were ultimately insufficient to meet benefits when due
 - if the last remaining employer defaulted and the employer (allowing for any remaining guarantee arrangements) was unable to meet its exit requirements
- 4.44 One employer (with a smaller share, approximately 5% of liabilities) has no active members and is almost sufficiently funded (as at 31 March 2016) to be able to exit the fund. The other employer has remaining but reducing active members and has in

collaboration with the Administering Authority taken significant steps in recent years towards reducing reliance on employer covenant and ensuring solvency.

Ongoing contributions are around 25% of pensionable pay. These are supplemented by around £7m per year to help pay off the deficit. This leads to total contributions of around 80% of payroll. This represents a significant commitment on the part of the employer towards the solvency of the fund.

Independent covenant review, obtained from specialist advisers appointed by the Administering Authority, assessed employer strength as "tending to strong", as at March 2016.

The fund's assets include a Prudential 'buy in' product. This was implemented to cover all pensioners as at 2011, albeit excluding increases in payment. We understand further asset changes are underway to protect the funding position.

- 4.45 We have engaged extensively with the administering authority for WMITA. We also engaged with the respective employers following the dry run. We understand the administering authority recognises the risk and is working to mitigate it.

Recommendations

- 4.46 A plan should be put in place for WMITA to ensure that members' benefits are able to be met from the fund when due in an environment of no future employer contributions being available, to ensure the aims of section 13 are achieved.
- 4.47 We recommend that the administering authority put such a plan in place and that MHCLG review that plan.
- 4.48 Following our dry run report, the only other passenger transport fund in existence at that time has merged with the Greater Manchester Pension Fund. Such a merger could reduce the dependency on a single employer.

Recommendation 4: We recommend that the administering authority put a plan in place to ensure that the benefits of members in the West Midlands Integrated Transport Authority Pension Fund can continue to be paid in the event that employers' contributions, including any exit payments made, are insufficient to meet those liabilities.

5

Long term cost efficiency



Key long term cost efficiency findings

- Funding levels have improved on a best estimate basis, partly as a result of asset performance and partly due to increased contribution levels since the dry run.
- In total, 83 out of 89 funds had green flags on all long term cost efficiency measures. There are a total of 6 amber and no red flags, an improvement since the dry run (14 amber and 3 red).
- We recommend all funds review their funding strategy statement to ensure handling of surplus or deficit is fair to both current and future taxpayers.
- A small number of funds have extended their deficit recovery plan in conjunction with a reduction in employer contributions.

5.1 Under section 13(4)(c) of the Act, the Government Actuary must report on whether the rate of employer contributions to the pension fund is set at an appropriate level to ensure the long term cost efficiency¹⁶ of the scheme, so far as relating to the pension fund.

5.2 In this chapter we:

- provide a definition of long term cost efficiency
- provide some background on long term cost efficiency issues, and the measures and flags we have used in considering them
- set out flagged long term cost efficiency issues: deficit reconciliation and deficit recovery period

Definition of long term cost efficiency

5.3 In line with the definition in CIPFA's Funding Strategy Statement guidance¹⁷, which we adopt for the purposes of section 13, we consider that the rate of employer contributions has been set at an appropriate level to ensure long term cost efficiency if the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

Background on long term cost efficiency

5.4 Long term cost efficiency relates to not deferring payments too far into the future so that they affect future generations of taxpayers disproportionately.

¹⁶ Explanatory notes to the Act state that: "long term cost efficiency implies that the rate must not be set at a level that gives rise to additional costs. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the time."

¹⁷ <http://www.cipfa.org/policy-and-guidance/publications/p/preparing-and-maintaining-a-funding-strategy-statement-in-the-lgps-2016-edition>

- 5.5 Following the 2013 valuations, 13 funds (14%) were in surplus on our best estimate basis. Following the 2016 valuations, that number has improved significantly to around 60 funds (67%). This follows a particularly strong period of asset outperformance, but also greater levels of contributions being paid into some funds.
- 5.6 Since much of our focus under long term cost efficiency is around deficit recovery on the best estimate basis, there are few flags being raised, and some of the flags raised in the dry run have been eliminated. In total, 83 out of 89 funds had green flags on all long term cost efficiency measures. There are a total of 6 amber and no red flags, an improvement since the dry run (14 amber and 3 red).
- 5.7 Other than Deficit Reconciliation and Deficit Recovery Period no flags were raised under the other long term cost efficiency measures. This can be interpreted as the funds' employers are on average paying sufficient contributions into their funds at present.
- 5.8 The two funds that gave rise to concerns in the 2013 dry run report were:
- Royal County of Berkshire Pension Fund
 - Somerset County Council Pension Fund
- 5.9 Both Berkshire and Somerset Pension Funds flagged under all 2013 LTCE measures other than deficit extension.
- 5.10 Both funds' employers have addressed many of the concerns raised, and in particular have increased their contributions compared to the 2013 contributions in addition to both funds benefitting from improved funding levels.

- 5.11 For the 2016 report, Berkshire raises a flag under the deficit period measure. On further engagement, Berkshire indicated a commitment to repaying the deficit. Berkshire also flagged on funding level under solvency.
- 5.12 Somerset does not raise any flags under LTCE measures in the 2016 report.

Deficit reconciliation

- 5.13 CIPFA's Funding Strategy Statement guidance¹⁸ states "Administering authorities should avoid continually extending deficit recovery periods at each and subsequent actuarial valuations. Over time and given stable market conditions, administering authorities should aim to reduce deficit recovery periods."
- 5.14 There are different interpretations of CIPFA's guidance – in particular 'deficit recovery periods' might be interpreted to mean either:
- the period over which deficit recovery contributions are paid (a recovery plan following the 2013 valuations might have been payable over the 2014 to 2034), in which case the CIPFA guidance suggests the period should not be continually extended beyond 2034
 - the length of period – ie 20 years in the example above – in which case the CIPFA guidance suggests 20 years should not be continually increased and in stable market conditions, administering authorities should aim to reduce the length of the deficit recovery period
- 5.15 This first interpretation is in line with guidance from the Pensions Regulator (tPR) for private sector schemes. We believe that, despite differences in environment and covenant value of employers, principles set out by tPR are a useful guide.

¹⁸ <http://www.cipfa.org/policy-and-guidance/publications/p/preparing-and-maintaining-a-funding-strategy-statement-in-the-lgps-2016-edition>

5.16 An extract of tPR's funding statements is reproduced below.

Type	Scheme characteristics	What we expect of trustees
a. With strong or tending to strong employers	Where the scheme's funding position is on track to meet their funding objectives and where technical provisions are not weak and recovery plans are not unduly long	As a minimum to continue with their current pace of funding by not extending their recovery plan end dates unless there is good reason to do so
b. With strong or tending to strong employers	With a combination of weak technical provisions and long recovery plans.	To seek higher contributions now to mitigate against the risk of the employer covenant weakening and other scheme risks materializing in the future

5.17 We believe it is appropriate for funds to consider their plans for the duration of the deficit recovery period, so that future contributions are recognised and these form part of employers' budgeting process.

5.18 We understand that new deficit may emerge between valuations, as a result of the fund's experience, in which case it may be appropriate to extend the recovery period. For example, if a fund within the last three years of its deficit recovery period experienced a material reduction in its funding level, it may not be appropriate in the context of fairness between current and future generations of taxpayers to repay that new deficit within three years.

5.19 We consider that reconciliation of the deficit recovery plan is an important component of section 13 for all funds.

5.20 Through this exercise, we have identified and engaged with a number of funds that have extended their deficit recovery end points. We have not concluded that this implies the aims of section 13 are not achieved, however we do recommend that all funds review their funding strategy and consider whether this is in accordance with the CIPFA guidance referred to above.

5.21 We would not normally expect to see employer contribution rates decreasing (reducing the burden on current taxpayers) at the same time as the deficit recovery end point being extended further into the future (increasing the burden on future taxpayers).

Recommendation 5: We recommend that all funds review their funding strategy to ensure that the handling of surplus or deficit is consistent with CIPFA guidance and that the deficit recovery plan can be demonstrated to be a continuation of the previous plan, after allowing for actual fund experience.

5.22 A significant minority of funds (37 of 91) have maintained their plans to eliminate their deficit (on their own funding basis). Of the remaining 54 funds, according to the data provided, 37 had increased contributions and 5 left them unchanged (expressed as a percentage of pensionable pay). We have engaged with the remaining 12. Through the engagement process, 8 were able to demonstrate that they had in fact increased contributions, or that their chances of deficit recovery are not reduced at the previous end point. We consider this is consistent with the aims of section 13.

Table 5.1 – Funds with an amber flag on deficit reconciliation measure

Pension fund	Deficit recovery plan
London Borough of Lambeth Pension Fund	+ 3 years
London Borough of Merton Pension Fund	+ 3 years
London Borough of Newham Pension Fund	+ 3 years
Royal Borough of Kingston Upon Thames Pension Fund	+ 2 years

5.23 We acknowledge that extending deficit recovery periods is appropriate in some circumstances, for example when new deficit emerges.

5.24 We engaged with those funds who appear to have extended their deficit recovery end point in conjunction with a reduction in overall contributions. However, where funds have been able to demonstrate that the probability of being fully funded at the previous recovery plan end point is not reduced, we have not flagged them.

Commentary from engagement in relation to deficit reconciliation

5.25 We have engaged with the funds listed above and listened to their decision making process in relation to this aspect.

London Borough of Lambeth Pension Fund

5.26 Following the 2013 valuation, Lambeth council opted to pay more than their actuary's central recommendations which would have implied a shorter recovery period than that set out in their funding plan at those times and requested that the Rates and Adjustments Certificates reflect their desire to pay more than required. However, as a result of budgetary pressures, the council have needed to reduce contributions. Therefore, some of the reduction in the 2016 SCR has been driven by the removal of these additional

contributions which will have given the appearance of the fund extending its deficit recovery plan (but in actuality this put them back onto the underlying plan).

5.27 In addition, the fund reviewed both its funding and investment strategies with the ultimate goal of giving the Fund a two-thirds probability of full funding over a 20 year period.

London Borough of Merton Pension Fund

5.28 Similarly to Lambeth, Merton council opted to pay significant additional contributions into the fund following the 2013 valuation. They paid these contributions in lump sum form, rather than spreading them, and subsequently have had to reduce their contributions to a level below the 2013 level, excluding the lump sum contributions.

5.29 We acknowledge that Merton have made considerable contributions, and have a relatively short deficit recovery period. However, we have retained the flag, because following the 2016 valuation employer contribution rates were decreased (reducing the burden on current taxpayers) while at the same time as extending the deficit recovery end point (increasing the burden on future taxpayers).

London Borough of Newham Pension Fund

- 5.30 Newham council stated they paid contributions above minimum into the fund following the 2013 valuation and subsequently have had to reduce their contributions to a level below the 2013 level.

Royal Borough of Kingston upon Thames Pension Fund

- 5.31 Kingston extended their deficit recovery end point by 2 years. Kingston have also reduced their contributions by around 2%. They indicate that the level of contributions is above the minimum level implied by their actuary's model.
- 5.32 In general, most funds referred to the improvement in funding level and affordability of contributions in the light of other demands on budgets. These are all valid concerns, however we consider under section 13 that this involves a risk under long term cost efficiency.

Deficit recovery period

- 5.33 We included, as a relative measure, deficit recovery period. This refers to the period expected to repay the deficit, restated on our best estimate basis (see Appendix G), on

the assumption that fund contributions are maintained at the current level.

- 5.34 Two funds also flagged on our deficit recovery period measure, having particularly long deficit recovery periods (after adjusting to our standardised best estimate basis). We consider this to be a risk, but not on its own, contrary to the aims of section 13 under long term cost efficiency, noting that these two funds appear in Table 4.1: Funds with an amber flag on SAB funding level.

Commentary from engagement in relation to deficit recovery period

- 5.35 In this case, we consider that these funds are carrying a risk that fund managers should be aware of, but we do not consider this sufficient to warrant a recommendation.
- 5.36 In our engagement with the Brent Pension Fund it is clear that Brent have taken significant steps towards addressing the deficit. Contribution rates are relatively high at an average of 33.6% of pensionable pay over the period 2017/18 to 2019/20 and the deficit recovery plan has been adhered to (the recovery period has reduced from 22 years at 2013 to 19 years at 2016, maintaining the same deficit recovery period end point). This demonstrates that Brent understands the issue and have made a strong commitment to reducing the deficit.

Table 5.2: Open funds with amber flag on deficit recovery period

Pension fund	Deficit recovery period (years)
London Borough of Brent Pension Fund	10
Royal County of Berkshire Pension Fund	13

Dear Sirs

Local Government Pension Scheme 2016 Section 13 Valuation

We are writing to you as the responsible authority for the LGPS and Chair of the Local Government Pension Scheme Advisory Board (England and Wales) on behalf of the four firms who provide actuarial advice to LGPS funds regarding the Section 13 review carried out by the Government Actuary's Department (GAD).

We recognise that the initial headline messages in the report are positive about the overall progress being made by the LGPS, and this has been identified in the initial press reports which have emerged since the report's publication. Clearly this is something which we are pleased to see. However, on reading the detail of the report we have some material concerns over its content. We believe that it is important to highlight these, as we do below, and that it is not in the interests of the LGPS for some of GAD's recommendations to be taken forward.

Our concerns relate to GAD's:

- lack of recognition of the LGPS's updated financial position and outlook;
- approach to engagement during the process;
- interpretation of consistency as applied to LGPS funding plans; and
- understanding of LGPS funding plans and expectation of how deficit recovery plans should be set.

We consider each of these areas in turn.

The LGPS Funding Position and Outlook

We believe that the LGPS's financial position has improved significantly over the last few years and, for most local authorities, we do not currently expect that monetary contributions will need to rise following the 2019 valuations (albeit the valuation date is still six months away so that cannot be guaranteed).

The Section 13 report is based on the position as at 31 March 2016. It does acknowledge the significant improvement in funding since 31 March 2013 (from 79% to 85% on average on prudent local bases and from 92% to 106% on average on GAD's best estimate market basis). However, despite being published 18 months after the 2016 valuations were signed off, the report does not acknowledge that the funding position would have been expected to increase further due to continuation of deficit contributions and due to the funds' strong asset performance since 2016. Instead, the report is largely focussed on highlighting perceived failures by Funds against a series of arguably rather arbitrary actuarial metrics, many of which focus on a single point when in fact there are a number of interrelated issues at play.

Our concerns are that readers (particularly lay readers) may conclude that:

- The LGPS is not being well managed from a funding perspective, with more than 20 amber or red flags being allocated.
- There will be significant employer contribution increases at the 2019 valuation based on GAD's asset liability modelling work (work which we believe goes beyond the remit and requirements of Section 13). Based on current financial conditions, this does not reflect what we expect will happen in reality and seems to emanate from GAD's assumption that contributions are set solely based on prevailing market conditions and gilt yields.

Engagement

We recognise that GAD do not carry out valuations of LGPS funds for funding purposes, so all four firms of actuarial advisers have invested considerable time and effort assisting GAD in their work preparing this report.

Our concerns are that:

- Very little of the extensive feedback that we provided has been reflected in the final approach and published report, and similarly for the feedback which has been provided by those clients consulted directly by GAD. It therefore seems to us that GAD have not taken fully into account how the LGPS is funded and how this differs from private sector schemes.
- The metrics are in our view too simplistic and could lead to incorrect/invalid conclusions. Whilst it is accepted that there is a balance to be struck between simplicity by applying metrics (where there is a risk of applying them rigidly despite them potentially offering limited insight) and a detailed bespoke analysis which would offer a more rounded view, in many cases, in our view, there hasn't been sufficient detailed engagement with the administering authority and Fund Actuary to understand local circumstances or the risk management measures already in place to mitigate the identified risks. Readers of the report will see the metrics used as a valid test (especially with the Red/Amber/Green classification used). This could influence funding behaviours in an effort to avoid a future red or amber flag and lead to lay readers drawing incorrect conclusions about the performance of a fund and its officers and committee. Ultimately this could result in actions being taken which are not in the best interests of the LGPS and/or individual funds.

We believe GAD should recognise more explicitly that these metrics are limited in nature and instead undertake a more holistic review of, and commentary on, funding plans with considerably more engagement with key stakeholders at individual funds.

Interpretation of consistency

We have no objection to GAD's recommendation in relation to presentational consistency (Recommendation 1) as long as any "template" reporting is provided in good time to be implemented and is mandatory (since some administering authorities may otherwise refuse to agree to any changes).

However, we fundamentally disagree with how GAD has approached what they call "evidential consistency": the wording in the Public Service Pensions Act is "not inconsistent" implying a focus on identifying outliers which is entirely logical for a review analysing and comparing local LGPS valuations. GAD has instead interpreted their role as requiring a comparison of individual assumptions (focusing on those used to calculate the past service funding level) and commenting on whether or not they are identical. Our concern is that readers will be given a completely false impression of what we understood to be the intentions of Section 13.

In addition, our concerns are that:

- There is very little commentary on the main output from a local LGPS funding valuation, i.e. the employer contributions payable. Given LGPS funds are open, ongoing and long term statutory schemes, the contributions payable are far more relevant and important than the assessment of the past service funding position (on which GAD has focused). We believe that there is far greater consistency in relation to employer contributions and the report as drafted will give readers a false impression of what is most important in the overall funding plan.
- GAD does not acknowledge that different assumptions and funding mechanisms are valid when setting employer contribution rates nor that this diversity in approach allows administering authorities to adopt the approach which maximises the chance that they meet their objectives in light of their appetite for risk and the specific circumstances of the Fund. Equally important, the Fund Actuary is required to have regard to the Funding Strategy Statement when carrying out the valuation. This is an administering authority document and administering authorities may appoint an adviser on the basis of the funding approach adopted. Our concern is that GAD's assertion that house views are responsible for the assumptions adopted for local valuations is misleading, ignores the administering authorities' (and employers') key role within the valuation process and does not provide an appropriately balanced view.

In putting forward Recommendation 2, GAD has neither outlined what the benefits for the LGPS and its stakeholders would be, nor has it considered the potential downsides in terms of the reduced input from the administering authority into the funding process and the fundamental change in governance arrangements which would be involved. A change of this nature needs to be considered from a policy point of view with consultation with all stakeholders, rather than being introduced by the back door. We therefore do not agree with Recommendation 2 and believe that the Scheme Advisory Board should consider the feedback we provided to GAD before taking this recommendation forward.

In particular, we believe that a better focus for the Section 13 review would have been:

- consideration of the consistency of output of the valuation, i.e. employer contribution rates rather than focusing on certain individual assumptions used to calculate funding levels;
- commentary and analysis of the overall funding strategy and assumptions, including level of prudence, rather than a focus on individual assumptions in isolation; and

- a comparison of employer contribution rates against funding levels (assessed on a standardised funding basis), which would give a visual representation of the above two points and some insight into relative prudence of the overall funding approach for each fund.

How deficit recovery periods should be set

Deficit recovery periods can form an important part of the funding strategy, particularly where funding levels are low, but in practice are often not key drivers of the contribution plan. Our concern is that the application of a strict “rules-based” approach could potentially inadvertently lead to the wrong conclusions in cases where the funding plan overall is robust and meets the cost-efficiency requirements. In particular:

- A fund wishing to adopt a more prudent actuarial valuation basis may be reluctant to do so if the result is an increased deficit recovery period and hence a risk of triggering on this measure.
- A fund which feels it can sensibly afford to adopt a more risk-averse investment strategy may decide against doing so if it will give rise to a longer deficit recovery period.
- When deficit recovery periods are relatively short, there comes a point where seeking to shorten them further at every actuarial valuation may lead to increased volatility of contributions and therefore come into conflict with cost-efficiency.
- Funds/employers may fall foul of this trigger simply due to seeking to manage their budgets prudently within their financial constraints (e.g. paying increased contributions whilst it can afford them with a view to reducing them in future years when its financial position is tighter).
- GAD has interpreted CIPFA’s guidance on deficit recovery periods to mean that these should have a fixed end date. However, as GAD has acknowledged, they were not part of discussions when the guidance was drawn up. During these discussions, we have already confirmed to GAD that a deficit recovery period was used to mean a number of years e.g. 20 years, so the intention was for funds to operate with a rolling recovery period which does not extend in the number of years. We are concerned that because GAD has a different interpretation of CIPFA’s guidance, even if funds follow that guidance on our advice, they may still be flagged on this metric.

We think it would make more sense for the deficit recovery period not to be flagged in isolation, but for a more rounded view of the funding plan to be taken in the context of viewing whether a fund meets the cost-efficiency requirement. Rather than Recommendation 5, of the report, we would have preferred to have seen:

- the deficit recovery period at this and the previous valuation being noted; and
- a flag being raised only if it were felt that the cost-efficiency requirement was not being met overall.

We are disappointed that after so many months of discussions we are in a position to have to write this letter to you. However, we feel very strongly that it is important to ensure that the requirements of Section 13 can be met whilst recognising the positive steps taken by local authorities to date so it does not become the driver of LGPS funding plans to the detriment of the vast majority of well-managed LGPS Funds and the public perception of the LGPS. One of the great strengths of the LGPS is that it is

funded, giving it a far greater degree of transparency and accountability particularly when compared with the other public service schemes. We would be more than happy to provide further input and gather further feedback from our administering authority clients if that would assist you in determining how best to respond to GAD's review.

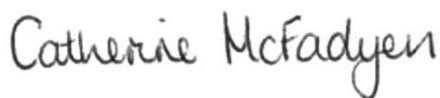
Yours faithfully



Alison Murray FFA
Partner
For and on behalf of Aon




Graeme Muir FFA
Partner
For and on behalf of Barnett Waddingham



Catherine McFadyen FFA
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<p>London Borough of Hammersmith & Fulham</p> <p>PENSIONS BOARD</p> <p>6 February 2019</p>	
<p>MINISTRY OF HOUSING, COMMUNITIES & LOCAL GOVERNMENT (MHCLG) STATUTORY GUIDANCE ON ASSET POOLING IN THE LOCAL GOVERNMENT PENSION SCHEME CONSULTATION</p>	
<p>Report of the Strategic Director, Finance and Governance</p>	
<p>Open Report</p>	
<p>Classification - For Information</p>	
<p>Key Decision: No</p>	
<p>Wards Affected: None</p>	
<p>Accountable Director: Philip Triggs, Tri-Borough Director of Pensions & Treasury</p>	
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1. EXECUTIVE SUMMARY

- 1.1 The MHCLG has been preparing new statutory guidance on LGPS asset pooling. This guidance will set out the requirements on administering authorities, replacing previous guidance, and builds on previous ministerial communications and guidance on investment strategies.
- 1.2 They are now inviting views on the draft guidance and the consultation process will close on 28 March 2019.

2. RECOMMENDATIONS

- 2.1 The Pension Board is recommended to note the draft guidance on pooling and express any desired feedback for the consultation process.

3 MHCLG DRAFT GUIDANCE

- 3.1 A summary of the key points are as follows:

- 3.2 Pool members must appoint a pool company to implement their investment strategies, including the selection, appointment and dismissal of managers.
- 3.3 Pool members must establish and maintain a pool governance body in order to set the direction of the pool and to hold the pool company to account.
- 3.4 Pool members should transition existing assets into the pool as quickly and cost effectively as possible. Transition of listed assets should take place over a relatively short period. However, some existing investments may be retained by pool members on a temporary basis if the cost of moving the existing investment to a pool vehicle exceeds the benefits of doing so.
- 3.5 Pool members should normally make all new investments through the pool company in order to maximise the benefits of scale. Following the 2019 valuation, pool members will review their investment strategies and implement revised strategies 2020. From 2020, when new investment strategies are in place, pool members should make new investments outside the pool only in very limited circumstances.
- 3.6 There is no target for infrastructure investment for pool members or pools, but pool members are expected to set an ambition on investment in this area.
- 3.7 Pool members are required to report total investment costs and performance against benchmarks publicly and transparently in their annual reports, following the CIPFA guidance 'Preparing the Annual Report', with effect from the 2018-19 annual report.

4 CONSULTATION

- 4.1 Not Applicable

5 EQUALITY IMPLICATIONS

- 5.1 Not applicable

6 LEGAL IMPLICATIONS

- 6.1 None

7 FINANCE AND RESOURCES IMPLICATIONS

- 7.1 Finance risks are outlined within the report.

8 IMPLICATIONS FOR BUSINESS

- 8.1 Not applicable

9 RISK MANAGEMENT

- 9.1 Risks are outlined within the report.

10 PROCUREMENT IMPLICATIONS

10.1 None

11 IT STRATEGY IMPLICATIONS

11.1 None

LIST OF BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
1.	None		

LIST OF APPENDICES:

Appendix 1: MHCLG draft guidance on pooling

Local Government Pension Scheme

Statutory guidance on asset pooling

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- 2 Definitions**
- 3 Structure and scale**
- 4 Governance**
- 5 Transition of assets to the pool**
- 6 Making new investments outside the pool**
- 7 Infrastructure investment**
- 8 Reporting**

Foreword

The reform of investment management in the Local Government Pension Scheme (LGPS) for England and Wales began in 2015 with the publication of criteria and guidance on pooling of LGPS assets, following extensive consultation with the sector. LGPS administering authorities responded by coming together in groups of their own choosing to form eight asset pools.

Through the hard work and commitment of people across the scheme, those eight pools are now operational. Their scale makes them significant players at European or global level, and significant annual savings have already been delivered, with the pools forecasting savings of up to £2bn by 2033. Along the way many lessons have been learnt and great progress has been made in developing expertise and capacity, including in private markets and infrastructure investment.

This is a considerable achievement in itself, but there is still a long way to go to complete the transition of assets and to deliver the full benefits of scale. In the light of experience to date with pooling and the challenges ahead, authorities have requested guidance on a range of issues. The time is now right for new guidance to support further progress.

1 Introduction

1.1 This guidance sets out the requirements on administering authorities in relation to the pooling of LGPS assets, building on previous Ministerial communications and guidance on investment strategies, and taking account of the current state of progress on pooling. It is made under the powers conferred on the Secretary of State by Regulation 7(1) of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the 2016 Regulations). Administering authorities are required to act in accordance with it.

1.2 This guidance replaces the section at pages 7 to 8 of Part 2 of *Guidance for Preparing and Maintaining an Investment Strategy*, issued in September 2016 and revised in July 2017, which deals with regulation 7(2)(d) of the 2016 Regulations. It also replaces *Local Government Pension Scheme: Investment Reform Criteria and Guidance*, issued in November 2015.

2 Definitions

2.1 This guidance introduces a set of definitions for use in this and future guidance, as follows:

‘Pool’ the entity comprising all elements of a Local Government Pension Scheme (LGPS) asset pool

‘Pool member’ an LGPS administering authority which has committed to invest in an LGPS pool and participates in its governance

‘Pool governance body’ the body used by pool members to oversee the operation of the pool and ensure that the democratic link to pool members is maintained (for example, Joint Committees and officer committees)

‘Pool company’ the Financial Conduct Authority (FCA) regulated company which undertakes selection, appointment, dismissal and variation of terms of investment managers, and provides and operates pool vehicles for pool members

‘Pool fund’ a regulated unitised fund structure operated by a regulated pool company, such as an Authorised Contractual Scheme (ACS)

‘Pool vehicle’ an investment vehicle (including pool funds) made available to pool members by a regulated pool company

‘Pooled asset’ an investment for which the selection, appointment, dismissal and variation of terms for the investment manager is delegated to a regulated pool company, or an investment held in a pool vehicle

‘Retained asset’ an existing investment retained by a pool member during the transition period

‘Local asset’ a new investment by a pool member which is not a pooled asset

3 Structure and scale

3.1 All administering authorities must pool their assets in order to deliver the benefits of scale and collaboration. These include:

- reduced investment costs without affecting gross risk-adjusted returns
- reduced costs for services such as custody, and for procurement
- strengthened governance and stewardship and dissemination of good practice
- greater investment management capacity and capability in the pool companies, including in private markets
- increased transparency on total investment management costs
- diversification of risk through providing access to a wider range of asset classes, including infrastructure investments

3.2 In order to maximise the benefits of scale, pool members must appoint a pool company or companies to implement their investment strategies. This includes:

- the selection, appointment, dismissal and variation of terms of investment managers, whether internal or external

- the management of internally managed investments
- the provision and management of pool vehicles including pool funds

It is for the pool companies to decide which investment managers to use for pool vehicles, including whether to use in-house or external management. Pool members may continue to decide if they wish to invest via in-house or externally managed vehicles.

3.3 Pool companies may be wholly owned by pool members as shareholders or may be procured and appointed by the pool members as clients.

3.4 A pool company must be a company regulated by the Financial Conduct Authority (FCA) with appropriate FCA permissions for regulated activities. This helps ensure the pools comply with financial services legislation, and provides additional assurance to scheme members and employers. Depending on the structure of the pool, appropriate permissions may include permissions for execution, acting as agent, provision of advice, or such other permissions as required by the FCA. Where regulated funds (e.g. in an ACS) are operated by the pool company it should comply with relevant UK legislation.

Regular review of services and procurement

3.5 Pool governance bodies, working with the pool company, should regularly review the provision of services to the pool, and the process of procurement, to ensure value for money and cost transparency. Where services are procured or shared by pool members, pool members should regularly review the rationale and cost-effectiveness of such arrangements, compared to procurement and management through the pool company. Pool members and pool companies should consider using the national LGPS procurement frameworks (www.nationallgpsframeworks.org) where appropriate.

Regular review of active and passive management

3.6 Pool members, working with the pool company, should regularly review the balance between active and passive management in the light of performance net of total costs. They should consider moving from active to passive management where active management has not generated better net performance over a reasonable period. Pool members should also seek to ensure performance by asset class net of total costs is at least comparable with market performance for similar risk profiles.

4 Governance

4.1 Pool members must establish and maintain a pool governance body in order to set the direction of the pool and to hold the pool company to account. Pool governance bodies should be appropriately democratic and sufficiently resourced to provide for effective decision making and oversight.

4.2 Pool members, through their internal governance structures, are responsible for effective governance and for holding pool companies and other service providers to account. Strategic asset allocation remains the responsibility of pool members, recognising their authority's specific liability and cash-flow forecasts.

4.3 Members of Pension Committees are elected representatives with duties both to LGPS employers and members, and to local taxpayers. Those who serve on Pension Committees and equivalent governance bodies in LGPS administering authorities are, in many ways, required to act in the same way as trustees in terms of their duty of care to scheme employers and members, but are subject to a different legal framework, which derives from public law. In particular while they have legal responsibilities for the prudent and effective stewardship of LGPS funds, LGPS benefits are not dependent on their stewardship but are established and paid under statute in force at the time.

4.4 Those who serve on Pension Committees and equivalent governance bodies in pool members should therefore take a long term view of pooling implementation and costs. They should take account of the benefits across the pool and across the scheme as a whole, in the interests of scheme members, employers and local taxpayers, and should not seek simply to minimise costs in the short term.

4.5 Local Pension Boards of pool members have a key role in pool governance, given their responsibilities under the LGPS Regulations 2013 (regulation 106 (1)) for assisting authorities in securing compliance with legislation, and ensuring effective and efficient governance and administration of the LGPS. They can provide additional scrutiny and challenge to strengthen pool governance and reporting, and improve transparency and accountability for both members and employers.

4.6 Local Pension Boards may also provide a group of knowledgeable and experienced people from which observers may be drawn if pool members wish to include observers on pool governance bodies.

Strategic and tactical asset allocation

4.7 Pool members are responsible for deciding their investment strategy and asset allocation, and remain the beneficial owners of their assets, in accordance with *Guidance for Preparing and Maintaining an Investment Strategy*.

4.8 Pool members collectively through their pool governance bodies should decide the pool's policy on which aspects of asset allocation are strategic and should remain with the administering authority, and which are tactical and best undertaken by the pool company. Pool governance bodies, when determining where such decisions lie, should be mindful of the trade-off between greater choice and lower costs and should involve the pool company to ensure the debate is fully informed on the opportunities and efficiencies available through greater scale.

4.9 Providing pool members with asset allocation choices through an excessively wide range of pool vehicles or investment managers will restrict the pool company's ability to use scale to drive up value. On the other hand maximising scale by significantly limiting asset allocation options may not provide all pool members with the diversification needed to meet their particular liability profile and cash flow requirements. Pool members should set out in their Funding Strategy Statement and Investment Strategy Statement how they, through the pool governance body, have balanced these considerations and how they will keep this under regular review.

4.10 Where necessary to deliver the asset allocation required by pool members, pool companies may provide a range of pool vehicles and in addition arrange and manage segregated mandates or access to external specialist funds. Pool governance bodies should ensure that their regulated pool companies have in place the necessary permissions to enable pool vehicles to be made available where appropriate.

4.11 Determining where asset allocation decisions lie will not be a one-off decision as pool member requirements will change over time. Pool governance bodies should ensure that a regular review process, which involves both pool members and pool companies, is in place.

5 Transition of assets to the pool

5.1 Pool members should transition existing assets into the pool as quickly and cost effectively as possible. Transition of listed assets should take place over a relatively short period.

5.2 Pool governance bodies, working with pool companies and, where appointed, external transition managers, should seek to minimise transition costs to pool members while effectively balancing speed, cost and timing, taking into account exit or penalty costs and opportunities for crossing trades.

5.2 The transition process will incur direct or indirect costs which may fall unevenly across pool members. For example, where the selected managers are used by some pool members but not others. In such cases pool members who are already using the selected manager may incur significantly lower (if any) transition costs than those who do not.

5.3 Inter-authority payments (or other transfers of value) may be desirable in order to share these costs equitably between pool members. The Government's view is that such payments are investment costs within Regulation 4(5) of the 2016 Regulations, and payments made by a pool member to meet its agreed share of costs may be charged to the fund of that pool member, whether the payments are made to other pool members, the pool company, or another body by agreement.

Temporary retention of existing assets

5.4 In exceptional cases, some existing investments may be retained by pool members on a temporary basis. If the cost of moving the existing investment to a pool vehicle exceeds the benefits of doing so, it may be appropriate to continue to hold and manage the existing investment to maturity before reinvesting the funds through a pool vehicle.

5.5 In many cases there will be benefits in such retained assets being managed by the pool company in the interim. However pool members may retain the management of existing long term investment contracts where the penalty for early exit or transfer of management would be significant. These may include life insurance contracts ('life funds') accessed by pool members for the purpose of passive equity investment, and some infrastructure investments. Pool members may also retain existing direct property assets where these may be more effectively managed by pool members.

Regular review of retained assets

5.6 Pool members, working with the pool company, should undertake regular reviews (at least every three years) of retained assets and the rationale for keeping these assets outside the pool. They should review whether management by the pool company would deliver benefits. Pool members should consider the long term costs and benefits across the pool, taking account of the guidance on cost-sharing, and the presumption should be in favour of transition to pool vehicles or moving such assets to the management of the pool company.

6 Making new investments outside the pool

6.1 Pool members should normally make all new investments through the pool company in order to maximise the benefits of scale. Following the 2019 valuation, pool members will review their investment strategies and put revised strategies in place from 2020. From 2020, when new investment strategies are in place, pool members should make new investments outside the pool only in very limited circumstances.

6.2 A small proportion of a pool member's assets may be invested in local initiatives within the geographical area of the pool member or in products tailored to particular liabilities specific to that pool member. Local assets should:

- Not normally exceed an aggregate 5% of the value of the pool member's assets at the point of investment.
- Be subject to a similar assessment of risk, return and fit with investment strategy as any other investment.

6.3 Pool members may invest through pool vehicles in a pool other than their own where collaboration across pools or specialisation by pools can deliver improved net returns.

6.4 During the period of transition, while pool governance bodies and pool companies work together to determine and put in place the agreed range of pool vehicles, a pool member may make new investments outside the pool, if following consultation with the pool company, they consider this is essential to deliver their investment strategy. This exemption only applies until the pool vehicles needed to provide the agreed asset allocation are in place.

7 Infrastructure investment

7.1 Infrastructure investment has the potential to provide secure long term returns with a good fit to pension liabilities, and form part of investment strategies of authorities. The establishment of the pools was intended to provide the scale needed for cost-effective investment in infrastructure, and to increase capacity and capability to invest in infrastructure.

7.2 There is no target for infrastructure investment for pool members or pools, but pool members are expected to set an ambition on investment in this area. Pool companies may provide pool vehicles for investment in UK assets, or overseas assets, or both, as required to provide the risk and return profile to meet pool member investment strategies. However the Government expects pool companies to provide the capability and capacity for pools over time to move towards levels of infrastructure investment similar to overseas pension funds of comparable aggregate size.

7.3 Pool companies may provide pool vehicles for investment in existing (brownfield) or new (greenfield) infrastructure, based on an assessment of the benefits and risks in relation to pool member liabilities, and non-financial factors where relevant. Pool members may invest in their own geographic areas but the asset selection and allocation decisions should normally be taken by the pool company in order to manage any potential conflicts of interest effectively, maintain propriety, and ensure robust evaluation of the case for investment.

7.4 For the purpose of producing annual reports, infrastructure assets are defined in the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance *Preparing the Annual Report* as follows:

Infrastructure assets are the facilities and structures needed for the functioning of communities and to support economic development. When considered as an investment asset class, infrastructure investments are normally expected to have most of the following characteristics:

- *Substantially backed by durable physical assets;*
- *Long life and low risk of obsolescence;*
- *Identifiable and reliable cash flow, preferably either explicitly or implicitly inflation-linked;*
- *Revenues largely isolated from the business cycle and competition, for example, through long term contracts, regulated monopolies or high barriers to entry;*
- *Returns to show limited correlation to other asset classes.*

Key sectors for infrastructure include transportation networks, power generation, energy distribution and storage, water supply and distribution, communications networks, health and education facilities, social accommodation and private sector housing.

Conventional commercial property is not normally included, but where it forms part of a broader infrastructure asset, helps urban regeneration or serves societal needs it may be.

7.5 All residential property is included in this definition of infrastructure. It is not restricted to social accommodation or private sector housing.

7.6 A variety of platforms may be required to implement the infrastructure investment strategies of pool members. Pool companies are expected to provide access to a range of options over time including direct and co-investment opportunities.

8 Reporting

8.1 Pool members are required to report total investment costs and performance against benchmarks publicly and transparently in their annual reports, following the CIPFA guidance *Preparing the Annual Report*, with effect from the 2018-19 report.

8.2 In summary, pool member annual reports should include:

- opening and closing value and proportion of pooled assets by asset class
- opening and closing value and proportion of local assets by asset class
- net and gross performance of pooled assets by asset class
- total costs of pooled assets by asset class
- for actively managed listed assets, net performance by asset class net of total costs compared to appropriate passive indices over a one, three and five year period
- net and gross performance of local assets by asset class
- total costs of local assets by asset class
- asset transition during the reporting year
- transition plans for local assets
- pool set-up and transition costs, presented alongside in-year and cumulative savings from pooling
- ongoing investment management costs by type, with a breakdown between pooled assets and local assets

8.3 Investments should be classed as pool assets on the basis of the definition in the CIPFA guidance *Preparing the Annual Report*.

For the purpose of defining those assets which are classed as being within an asset pool, 'pooled assets' are those for which implementation of the investment strategy – i.e. the selection, appointment, dismissal and variation of terms for the investment managers (including internal managers) – has been contractually, transferred to a third party out with the individual pension fund's control.

8.4 Any investment where a pool member retains the day to day management, or the responsibility for selecting or reappointing an external manager, is not a pool asset.

8.5 Pool members should provide a rationale for all assets continuing to be held outside the pool, including the planned end date and performance net of costs including a comparison which costs of any comparable pool vehicles. They should also set out a high level plan for transition of assets.

8.6 The SAB will publish an annual report on the pools based on aggregated data from the pool member annual reports, in the Scheme Annual Report. Pool members should comply with all reasonable requests for any additional data and information from the SAB to enable it to publish a comprehensive report.

8.7 Pool members should ensure that pool companies report in line with the SAB Code of Cost Transparency. They should also ensure that pool companies require their internal and external investment managers to do so.

8.8 Pool members should also ensure that the annual report of the pool company is broadly consistent with the reports of pool members, and with the Scheme Annual Report, in so far as it relates to their investments, and that the report includes a narrative to explain differences. These may arise for example from reporting periods of pool companies which differ from that of the pool member.

8.9 Pool members are required to report any change which results in failure to meet the requirements of this guidance to the LGPS Scheme Advisory Board (SAB) and to MHCLG.