Worcestershire County Council

# Agenda
## Pensions Committee

## Tuesday, 19 March 2019, 9.30 am
## County Hall, Worcester

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# DISCLOSING INTERESTS

**There are now 2 types of interests:**
**'Disclosable pecuniary interests' and 'other disclosable interests'**

## WHAT IS A 'DISCLOSABLE PECUNIARY INTEREST' (DPI)?

- Any **employment**, office, trade or vocation carried on for profit or gain
- **Sponsorship** by a 3rd party of your member or election expenses
- Any **contract** for goods, services or works between the Council and you, a firm where you are a partner/director, or company in which you hold shares
- Interests in **land** in Worcestershire (including licence to occupy for a month or longer)
- **Shares** etc (with either a total nominal value above £25,000 or 1% of the total issued share capital) in companies with a place of business or land in Worcestershire.

**NB Your DPIs include the interests of your spouse/partner as well as you**

## WHAT MUST I DO WITH A DPI?

- **Register** it within 28 days and
- **Declare** it where you have a DPI in a matter at a particular meeting
  - you must **not participate** and you **must withdraw**.

**NB It is a criminal offence to participate in matters in which you have a DPI**

## WHAT ABOUT 'OTHER DISCLOSABLE INTERESTS'?

- No need to register them but
- You must **declare** them at a particular meeting where:
  You/your family/person or body with whom you are associated have a **pecuniary interest** in or **close connection** with the matter under discussion.

## WHAT ABOUT MEMBERSHIP OF ANOTHER AUTHORITY OR PUBLIC BODY?

You will not normally even need to declare this as an interest. The only exception is where the conflict of interest is so significant it is seen as likely to prejudice your judgement of the public interest.

## DO I HAVE TO WITHDRAW IF I HAVE A DISCLOSABLE INTEREST WHICH ISN'T A DPI?

Not normally. You must withdraw only if it:

- affects your **pecuniary interests OR**
  relates to a **planning or regulatory** matter
- **AND** it is seen as likely to **prejudice your judgement** of the public interest.

## DON'T FORGET

- If you have a disclosable interest at a meeting you must **disclose both its existence and nature** – 'as noted/recorded' is insufficient
- **Declarations must relate to specific business** on the agenda
  - General scattergun declarations are not needed and achieve little
- Breaches of most of the **DPI provisions** are now **criminal offences** which may be referred to the police which can on conviction by a court lead to fines up to £5,000 and disqualification up to 5 years
- Formal **dispensation** in respect of interests can be sought in appropriate cases.

Simon Mallinson Head of Legal and Democratic Services July 2012 WCC/SPM summary/f

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# Pensions Committee
# Tuesday, 19 March 2019, 9.30 am, County Hall, Worcester

**Membership:** Mr R W Banks (Chairman), Mr A I Hardman, Mr R C Lunn, Mr P Middlebrough and Mr P A Tuthill

**Coopted Members**

| | |
|---|---|
| Mr V Allison | Employer Representative |
| Mr A Becker | Employee Representative |
| Mr R J Phillips | Herefordshire Council |

## Agenda

| Item No | Subject | Page No |
|---|---|---|
| 1 | **Named Substitutes** | |
| 2 | **Apologies/Declarations of Interest** | |
| 3 | **Public Participation**<br>*Members of the public wishing to take part should notify the Head of Legal and Democratic Services in writing or by e-mail indicating the nature and content of their proposed participation no later than 9.00am on the working day before the meeting (in this case 18 March 2019). Further details are available on the Council's website. Enquiries can be made through the telephone number/e-mail address below.* | |
| 4 | **Confirmation of Minutes**<br>To confirm the Minutes of the meeting held on 21 January 2019 (previously circulated – pink pages) | |
| 5 | **Initial Strategic Asset Allocation Review** | 1 - 48 |
| 6 | **LGPS Central Update** | 49 - 50 |
| 7 | **Pensions Administration Strategy** | 51 - 72 |
| 8 | **Administering Authority Update** | 73 - 76 |
| 9 | **Worcestershire County Council Pension Fund Administration Budget 2019/20** | 77 - 82 |
| 10 | **Pension Fund Training Programme for Pension Committee Members and Pension Board** | 83 - 88 |

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All the above reports and supporting information can be accessed via the Council's website

Date of Issue: Monday, 11 March 2019

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**AGENDA ITEM 5**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# INITIAL STRATEGIC ASSET ALLOCATION REVIEW

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## Recommendation

**1. The Chief Financial Officer recommends that:**

**a) The initial strategic allocation review undertaken by Hymans Robertson LLP is noted and the Committee consider the key findings of the review detailed in the Executive Summary of the attached report (see Appendix); and**

**b) The Committee's comments are fed into the detailed strategic allocation review to be undertaken later in the year.**

## Background

2. Every three years the Fund takes stock of the performance and composition of the Fund's Strategic Asset Allocation with the aims of:

a) meeting the requirements of the Fund's draft 2019 Funding Strategy Statement when known;

b) maintaining targeted returns, and

c) improving the Fund's opportunity to minimise volatility of returns and optimising diversification of risk.

3. Given the improved funding position of the fund and the implementation of the Equity Protection Strategy, it was felt that it would be beneficial to conduct an interim review in advance of the 2019 actuarial valuation to assess the suitability of the current investment strategy and asset allocation set in 2016.

4. A tendering exercise was undertaken during November 2018 and suitable advisers from the National LGPS Framework were invited to put forward initial proposals as to how the Fund might carry out an interim review in advance of the valuation, taking into account:

a) the performance and composition of funds strategic asset allocation endorsed by the Pensions Committee in 2016;
b) The need for the Fund to consider options for suggested future changes to the fund's strategic asset allocation (taking on board the consideration of more dynamic equity protection options) with clear reasoned arguments and data analysis;
c) Improve the funds opportunity to minimise volatility of returns and optimising diversification of risk; and
d) Provide options for income generation whilst minimising the impact on returns

5. Hymans Robertson LLP were successful in December 2018 and their final report is attached as Appendix 1. The review takes into account any scope to improve the risk return profile of the Fund's investments, optimising diversification benefit where possible, whilst being mindful of contribution rates, income generation and the dynamic structured equity arrangement in place.

6. In order to test the impact of different variations in the strategy Hymans have carried out a mix of quantitative and qualitative analysis within this report. This high-level review takes into consideration the following aspects of the Fund's investment strategy.

- **Testing variations in strategy**
- **Structured Equity**
- **Investment strategy and funding affordability**
- **Currency hedging**
- **Income and net cashflow requirements**
- **Active versus passive management**
- **Interest rate and inflation hedging**
- **Investment pooling – Mapping to LGPS Central Ltd**
- **Investment beliefs**

7. David Walker from Hymans Robertson LLP will be presenting the key findings to Pensions Committee and these will then be considered alongside the detailed strategic allocation review to be conducted later in the year. This report provides a very good foundation for this review and highlights a number of key questions and considerations for Committee relating to areas such as the Structure equity and investment pooling.

8. In particular Hymans are supportive of the Committee's development of a core set of investment beliefs as a framework for decision making. Hymans believe that any recommendations from this report are tested against these beliefs to ensure there is a robust process for testing investment decisions that can stand up to scrutiny and can be clearly explained to external parties or new members of Committee

## Contact Points

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## Supporting Information

- Strategic Asset Allocation Review (Appendix)

## Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.

HYMANS ROBERTSON

# Worcestershire County Council Pension Fund

## Review of Investment Strategy

February 2019

David Walker, Partner
Emma Garrett, Associate Investment Consultant

For and on behalf of Hymans Robertson LLP

# Contents

# Executive Summary

This reports sets out the analysis and conclusions of a high level review of the Worcestershire County Council Pension Fund. It covers a broad range of investment issues. The key findings from the review are as follows:

- The Fund looks to be in a strong place in its ability to deliver the required return against the current funding plan. Equities are clearly the main driver of return but also a significant contributor to risk. While the structured equity solution will help manage this risk if held on a rolling basis, we believe this also has the potential to impact on expected returns.
- We believe there is an opportunity to marginally improve the expected return on Fund assets while reducing volatility by reducing the exposure to equities and allocating to alternative and income focussed assets such as multi-asset credit and private debt.
- We are supportive of committing additional monies to private debt and multi-asset credit but would consider the timing of implementation for multi-asset credit carefully. We also support the current programme to build up the allocation to property and infrastructure as diversifying, income focussed assets.
- De-risking into more liability focussed assets like gilts may be a more effective way of reducing risk than structured equity. However, we would not recommend doing this at present given the current outlook unless it was considered as part of a wider de-risking framework that also considered funding affordability.
- The future of the structured equity solution should consider the Fund's long term objectives and impact on funding. We are not in favour of a long term rolling allocation to structured equity given the potential impact on returns. If considering whether to extend the existing solution into 2020, the Committee would need to address:
    - whether pricing gives the required trade off in terms of downside protection and loss of upside; and
    - how important the risk reduction provided by a structured equity arrangement is to the funding approach and what impact it will have on funding of future service costs.
- We would not recommend the Fund look to de-risk into lower risk assets like gilts at present, but should instead focus on diversification of risk and revisit the potential for setting funding level triggers or a risk management framework as part of the upcoming valuation.
- Regarding currency risk, for the equity allocation our preference is not to try and predict the future direction of currency markets, or to implement currency hedging on a tactical basis. We do not see it as a strategic requirement for the Fund to hedge out its foreign currency exposure.
- The Fund is likely to continue to be cashflow negative and these demands may increase in the coming years. We believe work should be undertaken to understand the likely cashflow demands of the illiquid asset commitments like infrastructure, debt and property. We also propose the Committee look to establish a high level liquidity waterfall framework for accessing cash should it be required to fund any future investments or to pay member benefits.
- The split between active and passive management will depend on the Committee's belief in the ability of active management to add value. However, we believe there is merit in moving the corporate bond allocation to a passive approach.
- The Committee could also consider whether the split between market cap and multi-factor remains appropriate and whether the allocation to market cap could be reduced in favour of multi-factor. The

Committee will also need to engage with the Central pool to understand what equity style options will be offered within the pool.

- Interest rate and inflation risk can have a significant impact on the funding position and is an important risk consideration. Our preference would be for the Fund to focus on generating long term real returns and only consider hedging if looking at managing employer specific risks or if there was an improvement in the pricing or outlook for index-linked gilts.
- The options for mapping existing allocations across to LGPS Central should be carefully considered and a consistent framework applied to help review options and ensure good engagement with the pool. Immediate options for mapping existing allocations into LGPS Central should be considered for passive UK Equities and active Emerging market equities.
- Further strategic considerations are required for mapping the remainder of the equity allocation including passive equities ex UK, active Asian equity and factor based equities and also corporate bonds if a passive alternative is not preferred. In our view the available equity options do not meet the strategic objectives of the Fund and therefore further engagement with the Pool is needed.
- The Fund should look to engage with the Pool regarding solutions still in development or where no equivalent options are available for existing Fund allocations such as property, infrastructure, private debt and multi-asset credit.
- We are supportive of the Committee's development of a core set of investment beliefs as a framework for decision making. We believe that any recommendations from this report are tested against these beliefs to ensure there is a robust process for testing investment decisions that can stand up to scrutiny and can be clearly explained to external parties or new members of Committee.

We look forward to discussing this report with Committee.

Prepared by:-

David Walker, Partner

Emma Garrett, Associate Investment Consultant

28 January 2019

For and on behalf of Hymans Robertson LLP

# 1 Introduction

### Addressee

This report is addressed to the Pensions Committee ('the Committee') and officers of the Worcestershire County Council Pension Fund ("WCCPF"). This report sets out the conclusions of the independent high level review of the Fund's investment strategy and also makes recommendations on the asset allocation and mandate structure for the Fund's investment arrangements.

The report should not be disclosed to any third party except as required by law or regulatory obligation or with our prior written consent. Where this is permitted, the report may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

### Background

The Worcestershire County Council Pension Fund ("WCCPF") has appointed Hymans Robertson to provide an independent high level review of its investment strategy to serve as an interim review in advance of the 2019 actuarial valuation to assess the suitability of the current investment strategy and asset allocation set in 2016.

This review takes into account any scope to improve the risk return profile of the Fund's investments, optimising diversification benefit where possible, whilst being mindful of contribution rates, income generation and the dynamic structured equity arrangement in place.

In order to test the impact of different variations in the strategy we have carried out a mix of quantitative and qualitative analysis within this report. This high level review takes into consideration the following aspects of the Fund's investment strategy.

### Overview of current strategy

The Fund's current investment strategy had an overall best estimate average expected return of c.3.7% per annum in excess of CPI inflation at the 2016 valuation date. The Fund employs a mixture of active and passive investments and an equity protection strategy across its passive equity portfolio which is due to expire in July 2019. The Fund has also recently increased its allocation to alternative growth assets which are in the process of being funded.

### Testing variations in strategy

Assess the current strategic asset allocation by undertaking quantitative structure modelling on both the current allocation and a range of agreed alternative investment strategies to test their risk and return profiles.

### Structured Equity

Review the current structured equity arrangement in place and quantify the protection provided together with any associated risks.

Assess the impact on the Fund's return and volatility should the existing equity protection strategy be rolled forward and outline alternative ways of generating long term return whilst also providing equity risk protection.

### Investment strategy and funding affordability

Outline the current contribution rates and assess the sensitivity of funding assumptions to changes in the expected return and how this might impact on the affordability of contributions. Consider what a long term steady state investment strategy looks like for the Fund now it is close to 100% funded.

### Currency hedging

Provide a brief summary of the key benefits, risks and implementation considerations of currency hedging more generally including the ways in which currency hedging could be implemented in the Fund.

### Income and net cashflow requirements

Assess the likely cashflow requirements of the Fund in the short to medium term, considering potential income that could be sourced from existing mandates and potential income from new asset classes.

### Active versus passive management

Review the current active / passive split of the Fund's assets together with any factor tilts. Provide advice on the appropriateness of the split given the underlying mandates and investment management fees paid.

### Interest rate and inflation hedging

Our review will assess if this allocation continues to play a role as a protection asset given the current approach to funding and the focus on delivering long-term real returns. We will consider efficient ways of delivering a low-risk liquid protection solution, particularly if the Fund wishes to manage these risks at underlying employer level.

### Investment pooling – Mapping to LGPS Central Ltd

Review the funds currently on offer within the pool and consider how the Fund's existing assets could map across to the pooled fund offering. Take future pooling activity into account when providing any advice as part of the strategy review.

### Investment beliefs

We aim to highlight key considerations throughout each aspect of the strategy review in order to ensure that all investment decisions are conscious and accurately reflect Committee beliefs.

# 2 Overview of Current Strategy

### Current investment and funding position

The WCCPF was valued at £2.82bn as at end August 2018 and was 99% funded. The primary objective of the Fund's investment strategy is to ensure that sufficient assets are available to meet liabilities as they fall due and to maximise the expected return at an acceptable level of risk.

The Committee, taking into account the Fund's liability structure, has set its strategic investment asset allocation to meet this objective as detailed in Table 1 below. The Fund's current investment strategy had an overall best estimate average expected return, as calculated by the Fund Actuary at the time of the last actuarial valuation, of c.3.7% per annum in excess of CPI at the 2016 valuation date.

The Fund has recently increased its allocation to alternative growth assets, property and infrastructure, to improve diversification and reduce volatility of returns. These mandates are currently in the process of being funded and as at the end of September 2018, there remained c.£240m of undrawn commitments within the Fund's property and infrastructure portfolio.

The Fund maintains a high exposure to growth assets, with the allocation to equity making up c.75% of the Fund's overall strategic asset allocation. To manage the market risk associated with this high growth strategy the Fund employs an equity protection arrangement which is due to expire in July 2019. The fund also holds some synthetic equity exposure across a proportion of the passive UK Equities held.

The Fund is currently marginally cashflow negative due to a number of main employers within the pension fund prepaying their 3 year contributions in April 2017. This, together with the likelihood that employers will seek to reduce or extend deficit repayments at the 2019 valuation requires the Fund to increase the level of income generated from its assets whilst minimising the impact on returns as much as possible.

**Table 1: Current investment strategy**

| Asset allocation | Target % |
|---|---|
| UK equity | 23.5 |
| Global equity | 41.5 |
| EM equity | 10.0 |
| **Total Growth** | 75.0 |
| Property | 4.0 |
| Real estate debt | 2.0 |
| Infrastructure | 9.0 |
| **Total Alternatives** | 15.0 |
| Private debt | 2.0 |
| Corporate bonds | 8.0 |
| **Total Fixed income** | 10.0 |
| **Total** | 100% |

## High level risk and return analysis

In order to test both the current and alternative investment strategies, we have carried out a mix of quantitative and qualitative analysis within this report.

The quantitative analysis is supported by our proprietary structure model. Further details of this modelling including the assumptions, are provided in Appendix 1 of this report. However, in summary, the modelling undertaken calculates expected returns and risk under various combinations of asset class returns and economic variables for a variety of predetermined asset allocations.

The modelling allows us to look at the expected return against liabilities and associated volatility of a variety of different investment strategies. It also allows us to show how each mandate contributes to the total risk within the portfolio. The charts below set out the analysis of the current investment strategy in terms of both the expected returns and the risk exposures within the portfolio.

**Chart 1: Expected return composition relative to cash (with and without structured equity arrangement)**

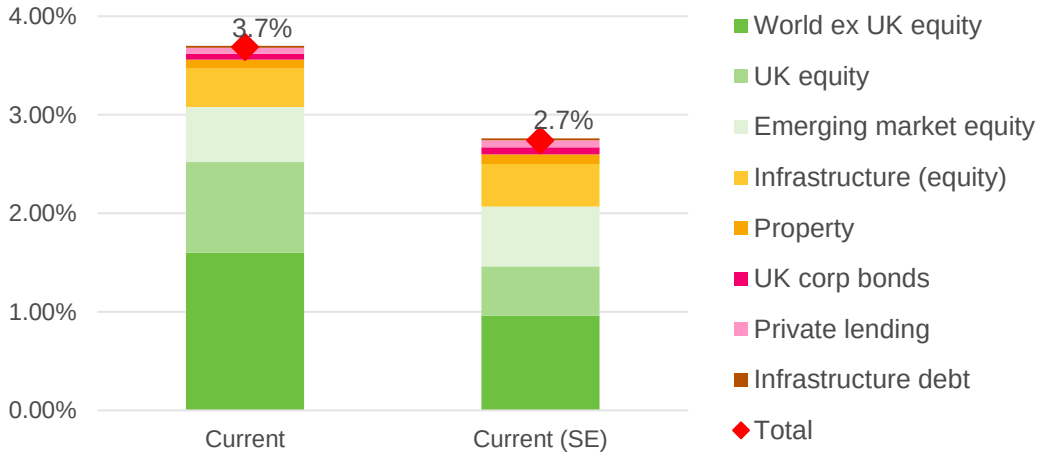



**Chart 2: Expected returns relative to CPI (with and without structured equity arrangement)**

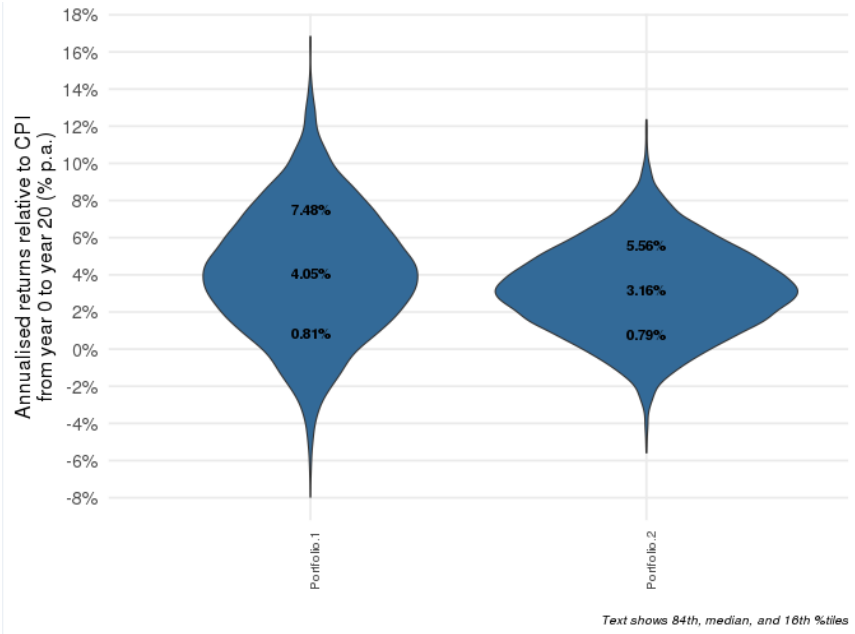
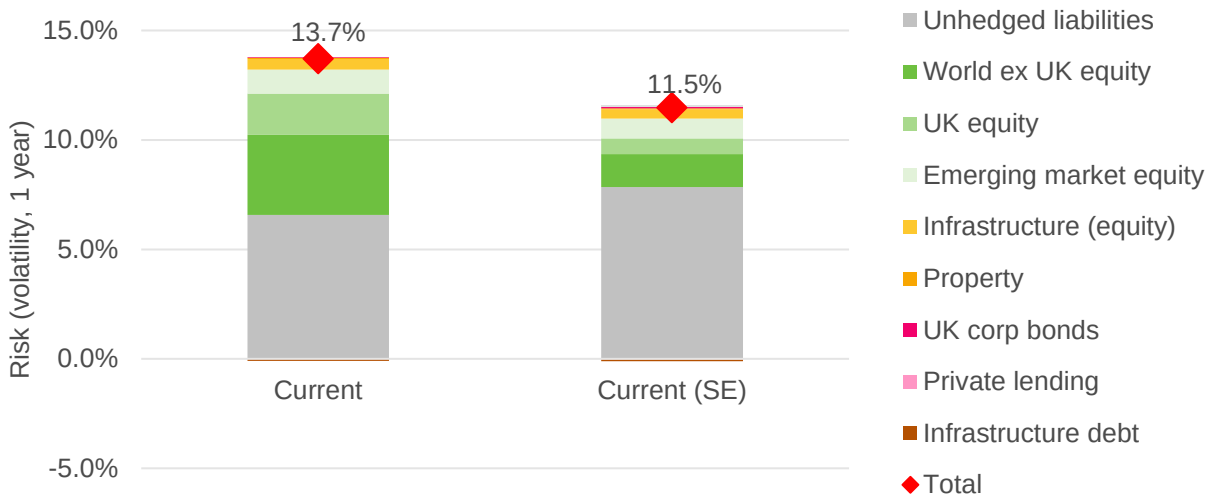


**Chart 3: Risk contribution (with and without structured equity arrangement)**




The above charts show expected returns and volatility of the current investment strategy with and without the structured equity arrangement ('SE'). Key points to note from the analysis above are:

- Chart 1 shows that the key drivers of expected returns are the Fund's allocation to equities (the green sections of the bars), with the Fund's allocation to alternative assets also modestly contributing.
- The median expected total return under the current investment strategy relative to cash is 3.7% with an annual volatility of 13.7%, with a rolling structured equity arrangement reducing both figures to 2.7% and 11.5% respectively.
- Chart 2 shows expected returns relative to CPI inflation. The Fund's expected return assumptions and valuation discount rate is derived relative to CPI. Both expected returns exceed the underlying valuation assumption of CPI+ 2.15% p.a. and CPI +2.75% p.a. for past and future service respectively.
- Chart 3 shows the Fund's allocation to equities as a large contributor to the overall Fund's risk allocation accounting for 6.7% of the 13.7% volatility measure. The equity component of the overall risk halves to 3.1% with the structured equity overlay.
- Whilst the yield risk of the un-hedged liabilities is large (the grey section of the chart) we view this more as a short term mark to market risk than a real risk as it combines both moves in interest rates and inflation which the current valuation approach is less sensitive to.

An important point in the above analysis is that we have allowed for the Fund's structured equity arrangement by modelling the arrangement as a portfolio of cash and equities, with the proportion split set by the Delta figures produced by River and Mercantile for the arrangement. A Delta figure provides a measure of the expected return of the arrangement relative to actual equity market movements.

Academic studies have shown that over the long term a rolling structured equity arrangement, such as a put-collar spread, tends to produce dampened equity returns similar to a portfolio of cash and equities. We discuss the structured equity solution in more detail in Section 4 of this report.

### Summary

The Fund looks to be in a strong place, being able to deliver the required return against the current funding plan. Equities are clearly the main driver of return but also a significant contributor to risk. While the structured equity solution will help manage this risk if held on a rolling basis we believe this also has the potential to impact on expected returns.

# 3 Testing variations in strategy

### Strategy modelling

This section of the report sets out the results of the quantitative modelling showing the impact on risk and expected return under a variety of different strategic asset allocations detailed in Table 2 below. Each of the five strategies has been modelled with and without the current structured equity arrangement (SE) in place.

**Table 2: Strategies modelled**

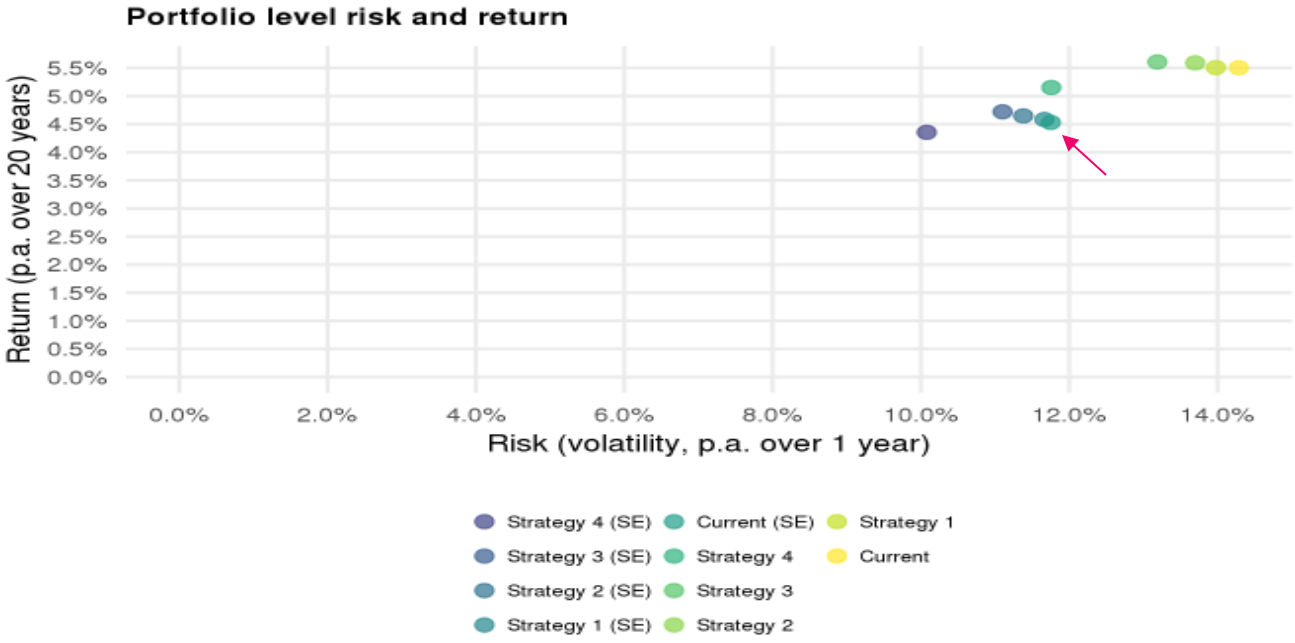
| | | Current | Strategy 1 | Strategy 2 | Strategy 3 | Strategy 4 |
|---|---|---|---|---|---|---|
| | UK equity | 23.5 | 21 | 21 | 19 | 16 |
| | Global equity | 41.5 | 40 | 40 | 38 | 32 |
| | EM equity | 10 | 9 | 9 | 8 | 7 |
| **Total Growth** | | **75** | **70** | **70** | **65** | **55** |
| | Property | 4 | 6.5 | 4 | 4 | 4 |
| | Real estate debt | 2 | 2 | 2 | 2 | 2 |
| | Infrastructure | 9 | 11.5 | 9 | 9 | 9 |
| **Total Alternative** | | **15** | **20** | **15** | **15** | **15** |
| | Multi asset credit | - | - | 8 | 10 | 10 |
| | Private debt | 2 | 2 | 2 | 5 | 5 |
| | Corporate Bonds | 8 | 8 | 5 | 5 | 5 |
| | Gilts | - | - | - | - | 5 |
| | IL Gilts | - | - | - | - | 5 |
| **Total Fixed Income** | | **10** | **10** | **15** | **20** | **30** |
| **Total** | | **100** | **100** | **100** | **100** | **100** |

The alternative strategies were chosen to explore the impact of increasing the Fund's allocation to alternative income generating credit assets as these assets will help to diversify equity risk, generate income and provide more stability to the Fund's return stream.

Strategy 4 includes a weighting to Gilts and Index Linked gilts with the aim of demonstrating the impact of a lower risk investment strategy should the Fund decide to implement a de-risking framework and is discussed in more detail in section 5 of this report.

## Analysis results

**Chart 4: Risk vs return of alternative strategies**




The Fund's current strategy including the impact of a rolling structured equity arrangement is highlighted by the pink arrow. This analysis shows:

- It is possible to marginally improve the expected return of the Fund's assets whilst simultaneously reducing volatility of returns by diversifying the Fund's growth allocation. This has been achieved in the modelling by either including higher allocations to multi asset credit and private debt or increasing allocations to property and infrastructure. Further investment in property and infrastructure have less impact on risk given the Fund already has allocations to these assets but would be positive from an income perspective.
- The impact of a rolling structured equity arrangement is expected to reduce both the volatility and expected returns of the Fund's assets.
- The Fund could afford to de-risk to strategy 4 and still have a higher expected return and reduced volatility than the current investment strategy with the structured equity overlay.
- The increased allocation to alternatives or fixed income under strategies 1, 2, 3 and 4, will improve the income generated from the Fund's assets to help meet the cashflow deficit without materially foregoing return.

## Qualitative views on investment strategy options

The above analysis set out our views on strategy options purely from a quantitative perspective. This takes into account our long term modelling assumptions on different asset classes which are calibrated to current market conditions. We believe it is prudent to overlay this with our more qualitative market views on asset classes from our investment research team which takes into account, fundamentals, valuations and technical factors which may drive the short to medium term outlook for each asset class.

## Summary of current asset class views

| Asset class | Current view | Comment |
|---|---|---|
| Equities | Neutral | Our overall assessment is 'Neutral' following the move down in equity valuations, which have taken global equities slightly below historical averages. Equity fundamentals look sound, although earnings momentum is fading, and visibility has deteriorated.<br><br>There remains a significant disparity in regional equity valuations. UK and Emerging Markets are below historical averages, whilst US equity valuations remain at a premium, albeit less so after recent market moves.<br><br>Technical factors are mixed. Whilst investor sentiment has been impacted by recent volatility, we view this as a healthy adjustment from the elevated levels of a year ago. The unwinding of central bank liquidity and the continued global trade disputes are two factors that continue to weigh on the equity outlook. |
| Property | Cautious | Low property yields now look stretched relative to UK and Global equities, leading to a downgrade in our overall view. Sector divergence remains stark and prospects for the retail sector continues to deteriorate. Long lease property view is neutral to cautious. |
| Real estate debt | Neutral - attractive | Our rating for speculative-grade commercial real estate (CRE) lending reflects even stronger lender protections and lower competition for investment, as banks and insurers avoid this area of the credit market. |
| Infrastructure | Neutral - attractive | We maintain our view that technical drivers are strong and could underpin further revaluation. We continue to favour implementations where managers focus on deals with a degree of complexity or areas where they have a competitive edge. |
| Multi asset credit | Neutral - cautious | We have moved our overall assessment of liquid speculative-grade credit upwards to Neutral – Cautious. This reflects the move in valuations closer to long term medians. However we are cautious on the increased risk to market sentiment from trade disputes and the outlook for global growth in 2019. |
| Private debt | Neutral | Our direct corporate lending rating reflects the better protection for lenders and a still-attractive yield premium over traded corporate markets. |
| Corporate bonds | Cautious | Global corporate spreads have moved above long-term median levels, improving our assessment of valuations. Yields relative to sterling corporates remain in-line with historic norms. A more positive relative valuation assessment is tempered by a less positive outlook for risk-free returns. |
| UK Gilts | Cautious - negative | Falling gilt yields over the quarter have edged down our overall assessment of conventional gilts to be in line with that on index-linked gilts. While hedging demand and economic uncertainty keep downwards pressure on yields, they remain far below our, and the Bank of England's, assessment of a long-term neutral level. |

*These ratings are intended to give a guide to our views on the prospects for markets over a period of around three years; although they are updated quarterly, they are not intended as tactical calls. The ratings reflect our expectations of absolute returns and assume no constraints on investment discretion. In practice, they need to be interpreted in the context of the strategic framework within which individual schemes are managed. The ratings ignore purchase costs, for property, in particular, they are therefore most relevant for current holders.*

### Key points from views in relation to strategic advice

From the comments above we can take the following in relation to the Fund's investment strategy:

- While the modelling supported an allocation to alternative credit markets from a strategic perspective we are slightly cautious on timing given pricing in some credit markets including asset backed securities (ABS) and high yield;
- The outlook is more supportive of an increased allocation to private debt which was also supported by the quantitative analysis;
- In the modelling we have not aimed to differentiate the opportunity within different equity markets but we note there are potential valuation differences across global markets;
- The outlook supports the Fund's current aim to build the allocation to infrastructure and potentially increase the target allocation; and
- While under strategy 4 we illustrated the risk reduction impact from investing in additional funds in UK gilts the outlook from a return perspective is currently fairly negative.

### Conclusions

Based on the quantitative and qualitative analysis set out in this section of the report, our views on the Fund's strategy are as follows:

- There is an opportunity to marginally improve the expected return of Fund assets while reducing volatility by reducing the exposure to equities and allocating to alternative and income focussed assets such as multi-asset credit and private debt or property and infrastructure;
- We are supportive of committing additional monies to private debt and multi-asset credit but would consider the timing of implementation for multi-asset credit carefully;
- We support the current programme to build up the allocation to infrastructure as a diversifying income focussed asset and potentially increase the current target to alternatives; and
- De-risking into more liability focussed assets like gilts may be a more effective way of reducing risk than structured equity, however, we would not recommend doing this at present given the current outlook unless considered as part of a wider de-risking framework that also considered funding affordability.

# 4 Structured equity

### Background to structured equity

Structured equity allows investors to restructure their equity return profile to their specific needs using equity derivatives, in particular options. By way of a reminder, options carry the right, but not the obligation, to buy or sell a stock or an index at a specified date in the future at a specified price. The most common solution considered is referred to as a 'put spread collar'. The key objective of this strategy is to keep investing in equities, but to buy some downside protection and pay for the premium by giving away some of the upside if equity markets rise more than expected (which is equivalent to de-risking if equity markets rise).

The payoff diagram of an example put spread collar (PSC) at expiry is shown in the chart on the right.

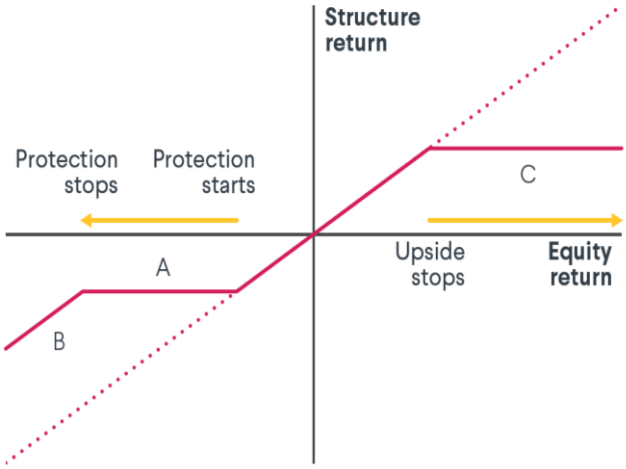
The PSC has three components:

A - Buy a put option, to protect equity return below a certain level by paying a premium.

B - Sell a put option, to remove the protection below a level lower than the floor to cheapen the premium.

C - Sell a call option, to give away equity return above a certain level to further cheapen the premium.

As is often the case, the level of upside given away by the call option can be chosen such that the premium from the overall structure is nil.




However, it would be equally valid to consider a PSC with a non-zero premium, particularly if there is a desire to retain more upside over the term of the option or if there was some asymmetry in pricing.

### WCCPF structured equity solution

WCCPF put a structured equity solution in place on a phased basis in February and March 2018 which is managed and implemented by River and Mercantile. The solution put in place was a PSC broadly in line with the illustrative diagram above. However, the implementation solution was split into 4 sections (Equity Derivative Overlay Strategy (EDOS) 1 to 4) and implemented in 3 tranches. This allowed River and Mercantile some freedom in execution of the trades against a range of constraints. The constraints included the capped upside on the return and the capital protection achieved on the downside. The contract terms were mostly 18-19 months and therefore will be scheduled to expire in June and July this year.

Of the 4 sections 1-3 focussed on different equity regions, namely US equities, European equities and UK equities and were implemented as overlays to existing allocations while section 4 was implemented as a replacement to an existing UK portfolio to allow the manager to manage collateral and margin requirements on the derivative exposures.

The levels of upside and downside caps and protections achieved were as follows:

**Table 3: Summary of structured equity solutions**

| Section | EDOS1 | EDOS2 | EDOS3 | EDOS4 |
|---|---|---|---|---|
| Equity market | US (S&P 500) | Europe (ESTOXX50) | UK (FTSE100) | UK (FTSE100) |
| Notional value | ~£300m | ~£200m | £408m | £240m |
| Capped return (%p.a.) | 6.0 | 5.0 | 5.0 | 5.0 |
| Protection target | 100 | 97 | 97 | 97 |
| Capital protection | 25.6 - 27.1 | 14.8 - 15.6 | 16.4 - 17.6 | 20.4 – 21.2 |

The Sections were all implemented at zero premium but there were underlying trading costs incurred and fees charged by River and Mercantile for the implementation and management of the solution. In Appendix 2 we have set out the expected payoff profile for each Section of the structured equity solution at expiry.

As shown in the table above we can see that:

- The solution was successful in providing a sizeable level of capital protection from downward movements in equity markets;
- Allowing for dividends the outright protection target levels were kept close to 100; and
- The capped returns at 5% p.a. and 6% p.a. meant the Fund still has exposure to sufficient potential equity market upside to exceed the actuarial valuation assumptions.

### Assessing impact of current solution

The assessment of whether the existing structured equity solution has been effective can we viewed in two ways. One is the actual impact on Fund's returns, or financial impact at the end of the period. This will be very much driven by realised markets returns and could result in the following views:

- If markets rose in excess of the capped return then the Fund may still be happy to have benefitted from some upside but regret having given some of this away;
- If markets stayed within the range between the level protection kicks in and the capped return then there would be no immediate benefit and a negative impact from transaction and running costs; or
- If markets fall below the level the protection starts then the Fund would benefit from the solution and be in a stronger position relative to being fully exposed to the market.

This approach does not take into account the overall risk benefit that has been gained from having the solution in place. Similar to any normal insurance policy, if we have to claim against the policy then it can be very valuable, if not then the premium can seem wasted, but how much value and reassurance is there from having the risk managed and insured? A key question for the Committee, is to understand how much value is gained in having the equity protection in place. We set out below a number of questions that the Committee might want to consider.

## What should WCCPF be asking themselves regarding structured equity?

### Is structured equity a part of a decision to reduce your Fund's risk for the longer-term?

Over the long-term, vanilla equity protection portfolios are expected to generate returns similar to a portfolio of equity and cash, i.e. dampened return and dampened volatility. Could you achieve similar long-term strategic benefits by selling equities and investing the proceeds elsewhere? Could the structured equity solution be designed to replicate expected returns from alternatives e.g. if we assume equities have a risk premium of c.3-4% p.a., with volatility of c.18%, designing an equity protection portfolio with a risk premium of (say) c.2-3% with lower volatility might act as a reasonable proxy for some alternative investments (even as an interim holding period while alternatives are being funded or if the alternatives are considered expensive).

### Is this a part of a decision to reduce your Fund's risk for the short or medium-term?

There are a number of governance related aspects to consider such as, why make this decision now, on what grounds will this decision be unwound, are there plans to roll the hedge, how will success be measured? If the decision to implement the solution is linked to the upcoming valuation, how does it fit with the Fund Actuary's approach to setting contributions and managing contribution volatility? Do you already have some protections "baked in" e.g. contribution stabilisation or long-term modelling of contributions meaning that the funding level on and around the valuation date is not a critical point in terms of the Fund's long-term future success? If so, does the proposed solution really add much to the Fund's risk management arrangements?

Our understanding is that the Fund Actuary is supportive of strategies such as equity protection to manage risk around valuation points and to help set funding contributions. However, it is not clear to us how short term market movements would automatically feed through into contributions rates. While asset movements would impact on funding levels through the stated asset value, most LGPS funding approaches take a longer term view in setting contribution rates that looks beyond this.

Before considering extending the existing solution we believe it would therefore be sensible to get a clear view from the Fund Actuary on how sensitive contributions rates would be to short term market movements and therefore how important it is to close down risk around the actuarial valuation date. This might vary at fund level versus underlying employer level depend on the funding approach adopted.

### What is the impact on return?

The PSC chart illustrates that the return profile of the PSC (the solid pink line) is quite different from that of holding equities alone (the dotted pink line), and in practice, this profile can be tailored to meet a pension fund's specific needs. The actual return achieved on the option strategy may be higher or lower than the market return for any given equity market outcome. However, options are not a free lunch. Even if an option strategy is sold as 'nil premium', it will typically cause a slight drag on the average expected return reflecting the price of the options (i.e. nil premium does not equal nil cost as there are transaction costs charged by the banks and the median expected return is not the same as the mean expected return). In addition to the price at time of being implemented, it is also important to consider how the value of an option strategy may change in response to changes in market conditions, such as an increase in equity volatility.

As demonstrated by the analysis set out in sections 2 and 3 of this report we believe that, if viewed as an ongoing strategy, equity protection can reduce expected returns. Part of this reason is the reduction in the range of expected returns, particularly from curtailing the upside which can reduce mean expected returns resulting in a return profile closer to a mix of equity and cash.

From a funding perspective one of the most volatile, and most significant parts of the funding equation, is the cost of future service benefits. This is not driven by existing asset volatility but the assumed return on assets. It is therefore important that the insurance of a structure equity solution, while helping manage deficit volatility, does not negatively impact on future service costs by reducing expected returns.

### What about the governance?

There are governance aspects to be considered. Questions to consider include, how does this fit with the Fund's cashflow needs (e.g. an equity market rally is likely to need cash collateral to be posted by the Fund), what are the fees that will be paid, what monitoring arrangements are needed and what training is needed for our elected members? None of these should be barriers to continued implementation of structured equity but are important considerations.

### Extending beyond summer 2019

We understand there have been discussions regarding the extension of the structure equity beyond 2019 to potentially coincide with the onset of the next funding plan coming into force. In order to assess the benefits of extending the structured equity solution we recommend the Committee address a number of points as outlined above:

- Current pricing – does the trade off in terms of downside protection and loss of upside give the Fund the desired level of insurance given the current market environment?
- Is this a long term strategy or are there other options for managing risk; extending the structured equity solution may be appropriate if there is a lead in time for funding other asset solutions; and
- How important is the risk reduction from structured equity to the funding approach and what impact will it have on funding of future service costs?

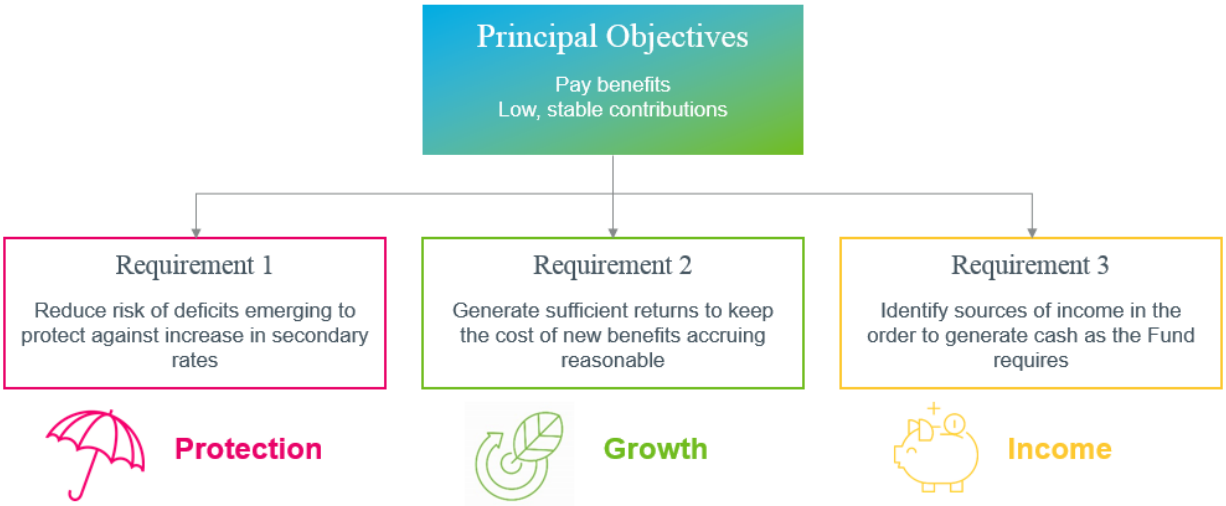
We believe a focus on objectives is key when setting strategy and therefore the use of structured equity should be considered with these objectives in mind.

# 5 Investment strategy and funding affordability

As outlined earlier in this report, over the last valuation cycle the Fund has seen improvements in funding level to the extent that the funding level stood at 99% in August 2018. While this will likely have fallen back a little as a result of the recent period of market volatility the strong position leads to questions on whether any action should be taken as a result of improvements in funding. Many funds in the LGPS are having discussions about de-risking, but the question is what are you de-risking towards? We believe risk should be considered in conjunction with objectives as both investment and funding strategies should be aligned with the aim of achieving agreed objectives.

### Understanding your objectives

The overarching objective of the Fund is to be able to provide pensions for current and future generations. However, LGPS funds are also tasked with the objective of keeping contributions affordable and stable. This is not an easy task and it can require us to balance sometimes conflicting requirements as set out in the diagram below.




We believe the aim should be to find a balance between investment risk and return that best meets your needs and is aligned to your objectives. This will include what the Committee deem to be an affordable long term contribution rate to target, which will then inform what investment risk is required to make this rate affordable and sustainable.

### Current investment and funding strategy

The assumptions underlying the current funding basis assumes that the Fund will be able to generate returns of CPI +2.15% p.a. to meet past service obligations and CPI +2.75% p.a. to meet future service costs. At the last actuarial valuation, a strategy was agreed which set an employer contribution rate of 15.3% of pay which, in combination with the investment returns, would be sufficient to recover the current deficit and meet future service costs.

As set out in sections 2 and 3 of this report we believe that the investment strategy is expected the generate returns which should exceed the actuarial funding assumptions by a prudent margin. With improvements in funding there is now the question as to whether investment risk can be reduced, noting that the assumptions also include a level of prudence in setting the discount rates relative to the best estimate expected returns.

Before answering the question on investment risk we first need to answer the question on objectives. Does the Committee view the 15.3% contribution rate as its long term affordable rate or not? If targeting a lower

contribution rate then this means the level of investment risk may have to be maintained (requirement 2 in the diagram).

As the valuation process for 2019 commences it's important the Committee engages with the Fund Actuary to set objectives to ensure both the funding and investment strategies are aligned.

### Risk management frameworks

In section 3 we modelled one strategy (strategy 4) which illustrated the impact of a 10% switch out of equity into a mix of fixed and index-linked gilts. This switch reduced the expected return on Fund assets by circa 0.5% from the current position but also resulted in a sizeable reduction in risk/volatility. This illustrates the need to balance requirements 1 and 2 in the diagram above.

We believe the Fund should only de-risk into lower risk assets like gilts when it is aligned to the long term objectives and that it is also affordable from a funding perspective, and won't negatively impact on contribution rates. To determine when the level of risk should be changed (which could include re-risking as well as de-risking) a risk management framework could be put in place that sets trigger points that would drive changes to the investment strategy.

Risk management frameworks can be set by testing strategies against agreed success and risk metrics. It is possible to test a range of strategies on the current position but also for various stress tests looking at changes in asset values or funding levels. This helps identify points at which the level of risk should be changed to either improve chances of success or to maintain chances of success but reducing the risks of adverse outcomes (e.g. having a less than 10% chance of funding levels falling back below 90% over the next valuation cycle).

We have not carried out this analysis as part of this review which has mainly focussed on the efficiency of the existing strategy that is in place. However, we do believe there is merit in Committee considering a risk management framework as part of the actuarial valuation process.

### Can the Fund de-risk now?

Based on the analysis in section 3 we believe that strategy 4 would still generate sufficient return to meet the funding requirements given the current level of prudence. However, the Fund actuary would need to confirm this would not have an impact on current funding costs. In the qualitative part of section 3 we also commented on the market outlook for lower risk assets like gilts which we do not think is particularly appealing.

We would not therefore recommend the Fund look to de-risk now but instead focus on diversification of risk and revisit the potential for setting triggers or a risk management framework as part of the upcoming valuation.

# 6 Currency hedging

### Currency exposure

The Fund is exposed to currency movements through its investments in overseas equities and investments in property and infrastructure. Any currency risk associated with the corporate bond holdings is 100% hedged back to GBP by JP Morgan.

**Table 4: Outline of currency exposures**

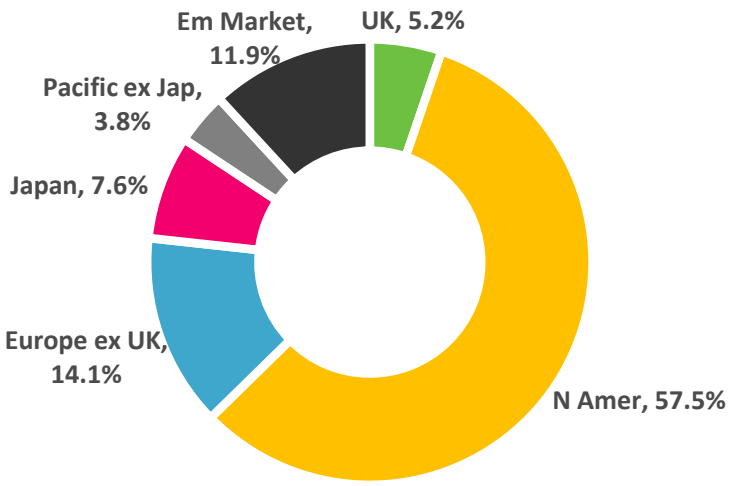
| Mandate | Strategic target | Currency Exposure? |
|---|---|---|
| **Actively managed Equities –** Far East and Emerging | 20% | Yes, currently unmanaged |
| **Passively managed Equities –** Market Cap | 40% | Yes, currently unmanaged |
| **Passively managed Equities –** Alternative Indices | 15% | Yes, currently unmanaged |
| **Actively managed Alternative –** Property and Infrastructure | 10% | Some, majority hedged back to GBP |
| **Actively managed Bonds –** corporate and direct lending | 15% | Some, majority of investments are in UK or hedged to GBP |

The majority of currency risk faced by the Fund is through its exposure to global equities, the Fund currently does not hedge any of its overseas currency exposure across the equity mandates. The table below provides details of the Fund's broad regional split for its equity holdings (split by index regional weights as at 31 December 2018).

**Table 5: Overseas equity currency exposure**

| Mandate | Target | UK | North America | Europe | Japan | Asia Pacific ex Japan | Emerging Markets |
|---|---|---|---|---|---|---|---|
| **Actively managed Equities** | | | | | | | |
| FTSE Developed Asia Pacific | **10%** | | | | 52.3% | 35.0% | 12.7% |
| FTSE All World Emerging Market | **10%** | | | | | | 100% |
| **Passively Managed Equities - Market Cap** | | | | | | | |
| FTSE All Share | **23.5%** | 100% | | | | | |
| FTSE All World North American | **9%** | | 100% | | | | |
| FTSE Developed Europe Ex. UK | **7.5%** | | | 100% | | | |
| **Passively managed Equities - Alternative Indices** | | | | | | | |
| FTSE RAFI Developed 1000 | **6%** | 9.5% | 53.7% | | 10.4% | 5.6% | 20.8% |
| MSCI World Minimum Volatility | **4.5%** | | 72.8% | 7.0% | 15.3% | 5.3% | |
| MSCI World Quality Total Return | **4.5%** | 9.0% | 82.0% | 6.10% | 3.4% | | |
| **Total** | **75%** | **24.5%** | **19.2%** | **8.1%** | **6.7%** | **4.1%** | **12.5%** |
| **% of equity allocation** | | **32.6%** | **25.6%** | **10.8%** | **8.9%** | **5.4%** | **16.7%** |

**Chart 5: MSCI World Developed All Countries as at 31 December 2018**




The Fund maintains a diverse equity portfolio across a range of regions but has a bias towards UK Equity exposure versus global market cap weights, with the US dollar accounting for the majority of the primary currency risk.

### Currency hedging

Putting in place a passive foreign currency hedge is designed to reduce the extent to which the value of the overseas investments fluctuate from one year to the next – i.e. reduce short/medium term volatility.

There is little evidence that currency hedging adds to returns over time; indeed, over the very long term, sterling has historically been a relatively weak currency and exposure to overseas currencies has had a positive impact for UK based investors. The outlook for the UK, both economically and politically, has changed significantly over the last year and there is no reason why sterling should necessarily revert to its previous levels.

Currency hedging is typically considered to reduce the overall risk of a portfolio, through removing the additional risk of currency fluctuations and leaving the residual risk of the underlying asset.

When investing in fixed income and credit assets we recommend always hedging returns back to sterling for UK investors. The rationale for investing in credit assets tends to be, in the most part, to generate a return from an income stream. Credit spreads do not typically compensate for the risk of currency movements eroding the income stream which could wipe out returns.

However, when considering if to hedge currency exposure within equities the rationale is less clear cut. Most of a global equity portfolio's volatility to a sterling investor relates to the volatility of the stock itself (as opposed to its currency exposure).

Historically currency hedging would have reduced volatility of equity returns. For example rolling 10 year equity volatility figures from the MSCI AC World index were 13.9% for GBP hedged returns vs 15.4% for unhedged returns since 1970.

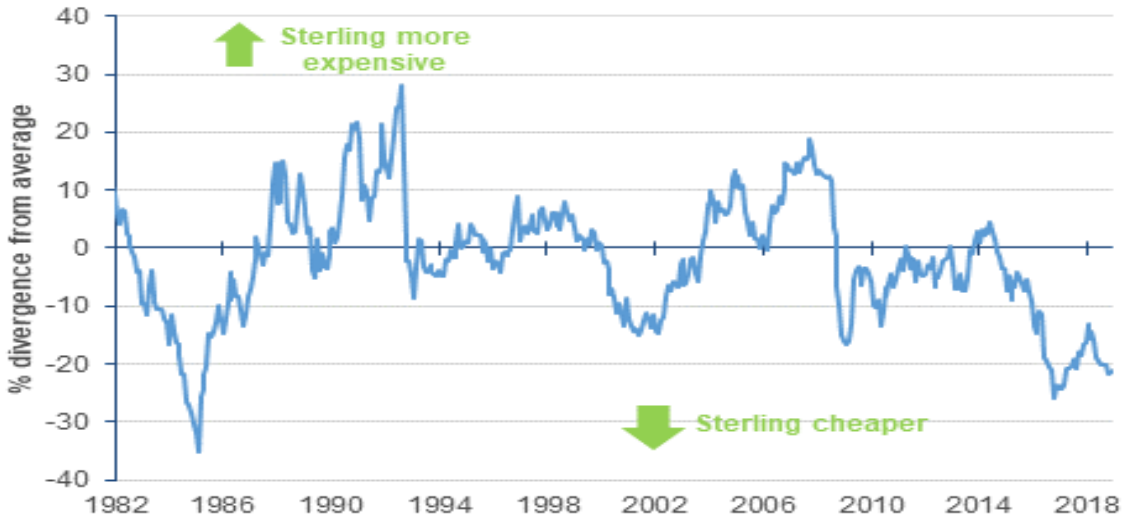
However, over the last 10 years currency hedging has not had the intended effect of reducing equity return volatility due to there being a significant correlation at times between equity market moves and currency moves. In fact over the last 10 years hedging has actually increased equity return volatility.

Following sterling's plunge since 2016, this may seem an appropriate time to increase hedging ratios to protect the windfall gains from currency exposure. A tactical assessment would typically involve (at least) three elements.

### I. Valuation

Although it is most relevant over the long term, valuation would be included. Often this will involve a comparison with the exchange rate against a level consistent with Purchasing Power Parity, based on the idea that exchange rates adjust over the long term to reflect relative inflation. Chart 5 compares the sterling- US dollar with its average CPI-inflation adjusted exchange rate since 1980 and suggests that sterling currently looks cheap.

**Chart 6: $/£ CPI adjusted**




### II. Fundamental

The chart also shows by how far and for how long exchange rates can diverge from PPP measures. Just because sterling looks cheap does not mean it is destined to strengthen quickly. Fundamental factors can have more influence over the medium term, e.g. the relative outlook for growth, divergence in monetary and fiscal policies, current account balances and capital flows. This may be particularly important in current circumstances, when structural changes to the UK economy following Brexit may diminish the importance of historic valuation as a guide to the future.

### III. Technical

Technical factors can dominate in the short term. Momentum is often a powerful force on the foreign exchanges and cost of carry (i.e. interest rate differentials) can drive significant speculative flows from one currency to another.

There is simply no one-size-fits-all answer to managing currency risk. The Committee should instead aim to construct an appropriate solution consistent with its investment objectives and beliefs. The Committee may therefore consider any of the following:

- Retaining the currency exposure as part of the ongoing exposure to global markets.
- Hedging a proportion to balance the risk of currency exposure being either a positive or negative.
- Making a more tactical assessment of the desired exposure subject to governance process being in place the make this type of decision effectively and to reassess the position over time.

### Implementation options

There are a number of ways in which the Fund could implement a currency hedge. These include:

- Investing in currency hedged funds. Passive managers will usually offer a hedged option for a small additional basis point fee (typically between 2-3 basis points (0.02-0.03% p.a.);
- Request the manager to hedge within their mandate. This is not something active managers will traditionally offer; or
- Implement a hedge through a segregated derivative overlay with a third party. This would require some collateral to be posted with the overlay provider. This could have more material operational implications in terms of managing any collateral and associated cash calls backing the hedging overlay.

Should the Committee be minded to hedge some of the overseas equity exposure, the most straightforward option would be to switch global passive exposure into a hedged share class. This might have limited impact given the regional structure of the Fund's equity mandates and that hedging can often be limited to developed markets and may omit Asian or Emerging countries.

To hedge a greater proportion of the exposure an overlay would be required. As the currency allocation is bespoke to the Fund, if the Committee would like to implement a currency hedging overlay it may need to be managed within the fund even following LGPS pooling. This could provide operational issues given the need to manage margin and collateral requirements.

The Fund also has a significant exposure to emerging market equities, it is very expensive to hedge this exposure and often the derivative instruments to do so may not exist or be traded liquidly. In addition, a key driver of emerging market equity returns is the exposure to the growth of a developing market currency, therefore we would not recommend trying to hedge this exposure.

| Arguments for hedging | Arguments against hedging |
|---|---|
| • FX may be regarded as an uncompensated source of risk(Assuming no long term downward trend in Sterling)<br>• Notable proportion of an overseas portfolio's volatility can be attributed to FX risk<br>• FX markets volatile in recent years<br>• We can insure against this risk by hedging<br>• FX risk can provide some diversification<br>– 100% FX hedge not optimal | • Relationship between equity return and FX<br>• Volatility impact over the long term<br>• FX hedging is not perfect<br>• Derivative counterparty risk<br>• Derivative regulation<br>• Management and trading costs<br>• Collateral and settlement (indirect costs)<br>• Implementation and monitoring complexity |

### Our view

On balance, our preference is not to try and predict the future direction of currency markets, or to implement currency hedging on a tactical basis. In our view, LGPS funds like Worcestershire can withstand short term volatility in the value of their investments as long as they are not required to sell assets on a regular basis to meet benefits.

Therefore, we do not see it as a strategic requirement for the Fund to hedge out its foreign currency exposure. However, the approach to managing currency risk should reflect the investment beliefs of the Committee and some of the considerations set out above.

# 7 Income and net cashflow requirements

### Cashflow position

The Fund is currently marginally cashflow negative due to a number of main employers within the pension fund prepaying their 3 year contributions in April 2017. This, together with the likelihood that employers will seek to reduce or extend deficit repayments at the 2019 valuation requires the Fund to increase the level of income generated from its assets whilst minimising the impact on returns as much as possible.

It is likely that the requirement for the Fund to generate more income to meet future liabilities and the pressure to reduce contributions will continue to grow as the Fund matures. The Fund also has c.£240m of undrawn commitments within the property and infrastructure portfolio and is currently disinvesting from equities as and when required to meet capital calls.

The Fund currently has no strategic allocation to cash and chooses to keep the amount of cash held within the Fund very low so as to maximise investment return. However this does introduce liquidity risk. It is therefore necessary to consider the most efficient way by which income can be sourced from the Fund's existing assets to mitigate this liquidity risk and prevent the Fund form being a forced seller of assets at potentially inopportune times.

### Existing assets

To bridge any future cashflow deficit the Fund could look to take any income naturally generated by the Fund's existing assets that is currently re-invested.

### Equities

The majority of the Fund's assets are invested in equities which produce regular income in the way of dividends. One way of accessing this income would be to switch the passive equities held into an income distributing share class, or to ask the active managers to distribute any available dividend income on an ongoing basis. However the amount of income produced is likely to be lumpy and the compounding effect of re-investing divided income is a key driver in equity growth which the Fund would have to forgo.

We believe it would be more efficient to take income from asset classes with an income focus and long term contractual like returns such as property, infrastructure, and alternative credit.

### Property and Infrastructure

The Fund has recently made a commitment (15% of total assets) to a mixture of Property, Infrastructure and Real Estate Debt mandates offering absolute returns of c6-12% p.a., these are currently in their drawdown phase.

It may take up to 3 years for the full capital commitment to be drawn down and invested before this level of income is generated. However this new commitment could be expected to generate an additional c.£37m of income p.a. for the Fund. The nature of these types of illiquid, closed ended investments means that work could be carried out to model the expected cashflow pattern over time to ensure the Fund achieves the strategic allocation being targeted but also is able to use the income rather than it being fully reinvested.

### New income generating assets

The strategy modelling in section 3 supports the Fund's ability to increase its allocation to some alternative credit assets such as multi-asset credit and private debt. These assets are attractive for the level of income they provide but also the predictability and stability of returns.

### Private debt

We believe the current trend for pension funds to provide more direct finance to businesses at the expense of banks will continue and that the rewards will be earned by those pension funds which are prepared to withstand a degree of illiquidity. At a time when yields on traded bonds have fallen to very low levels, there is still a material premium to be earned (of 1% - 2% p.a.) for less liquid forms of debt, reflecting the fact that the vast majority of investors cannot commit capital to these markets and are restricted to investing in bond market securities.

A number of funds now exist where specialist managers make a series of direct loans to businesses using capital committed primarily by pension funds. The credit quality tends to be reasonably strong and the loans generate a strong income stream from the outset. Potential returns in the region of 5% p.a. above LIBOR appear attractive against our current expectations from equities which are in the region of 6% p.a. Therefore, the Fund would not be giving up much in terms of expected returns by switching assets from equities into an investment where returns will be delivered in the form of a high and regular income stream.

We believe private debt is capable of providing strong growth but with reduced mark-to-market volatility and more transparency, and we prefer the visibility of return through contractual income offered by private debt opportunities.

Private debt funds are closed ended, and therefore the Fund could look to invest further in these opportunities ahead of asset pooling and retain the new investments outside of the pool. Alternatively, it would be possible to wait for suitable debt vehicles to be made available within the Central Pool.

### Multi-asset Credit

Mulit-asset credit strategies will invest in higher yielding bonds offering higher prospective returns in exchange for increased credit risk. However, they tend to be quite short dated or LIBOR linked - and therefore carry very limited interest rate risk. A portfolio might comprise investments in areas such as high yield bonds, emerging market debt, loans, asset-backed securities, etc.

Whilst we are attracted in principle to the yields on offer in multi asset credit, the extra yield available for the increased credit risk has been squeezed quite tightly in markets in recent months and, from a market timing perspective, we would ideally defer investment for the moment.

### Re-balancing and liquidity waterfall

Even with regular income being generated from the Fund's assets the Fund may need to access capital at short notice to meet outgo. The Fund is currently disinvesting from equities to meet any additional outgo not met by the current level of contributions and income.

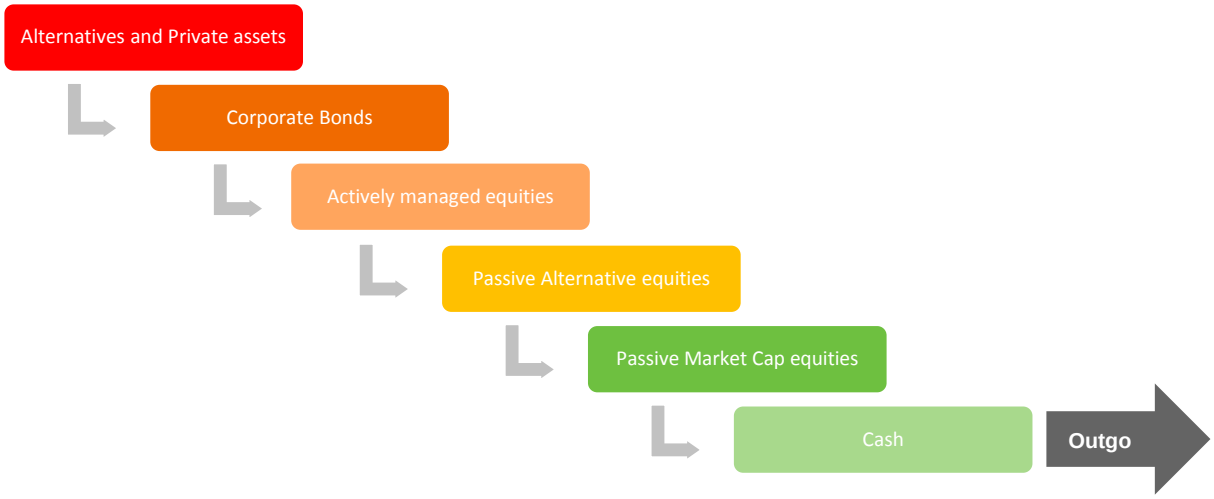
To limit liquidity risk and prevent the Fund from being a forced seller of assets we propose the Committee establish a formal re-balancing policy and liquidity waterfall framework.

The Committee currently monitors the Fund's investment strategy relative to the agreed strategic benchmark against the ranges in the table below. If ranges are breached, then appropriate action is taken by the Chief Financial Officer.

**Table 6: Rebalancing ranges**

| Asset Type | Strategic Target (%) | Range (%) |
|---|---|---|
| **Equities** | 75 | 70 – 85 |
| **Bonds** | 10 | 5 – 15 |
| **Infrastructure and Property** | 15 | 5 - 15 |

We propose the committee look to establish a high level liquidity waterfall for accessing cash should it be required to fund any future investments or to pay member benefits. An illustration of this is shown below.




1. Should access to funds be required instantly this should be sourced from the Funds most liquid asset, ideally cash. The Committee may wish to consider maintaining a small cash buffer.
2. If cash is unavailable funds should then be sourced from the next most liquid asset, passive market cap equities.
3. To prevent these liquid assets being depleted, they should then be replaced by the less liquid investments, over a short period.

To establish this waterfall process a more detailed re-balancing process would need to be put in place. Maintaining the strategic asset allocation will ensure the Fund is taking the right level of investment risk and that there remains sufficiently liquid assets to meet Fund outgo.

The parameters around such a waterfall structure should be determined by the Committee, taking into account the Fund's specific objectives and circumstances.

# 8 Active versus passive management

As discussed throughout this paper and in section 11, having a well-defined set of investment beliefs offers a number of advantages to the Committee including clarity on the rationale for each mandate held within the Fund and consistency around decision making. Beliefs can apply to high level strategy and risk appetite but also to the approach to investing in different asset classes and how these are accessed. For example, the belief that passive management has a role to play in a Fund's asset allocation, bringing liquidity, transparency and reducing fee levels.

In this section we review the Fund's investment approaches, first considering the split between active and passive management before going on to consider equity style biases. Throughout, we have looked to pull out what we believe the current arrangements indicate the Committee's beliefs are.

The table below sets out the Fund's current mandates and whether these are managed on an active or passive basis.

**Table 7: Fund investment summary**

| Mandate | Target allocation | Active/Passive |
|---|---|---|
| **Far East Developed** | 10% | Active |
| **Emerging Markets** | 10% | Active |
| **Global equities** | 55% | Passive |
| *Market cap* | *40%* | |
| *RAFI* | *6%* | |
| *Low Volatility* | *4.5%* | |
| *Quality* | *4.5%* | |
| **Total Equities** | 75% | 20% / 55% |
| **Fixed Interest** | 10% | Active |
| **Alternatives** | 15% | Active |

### Active vs passive

#### Equities

Around 45% of the Fund's mandates are managed on an active basis at total fund level and around 25% of the target equity allocation is actively managed. Active management is employed only in the emerging markets and far east regions, indicating the Committee believes markets in these regions are less efficient relative to other global regions.

Overall, the long term track record of active equity managers has been generally disappointing. The statistics for the LGPS sector supplied by WM show that active UK managers had added value of only 0.3% p.a. before fees relative to their benchmark over the 10 years to March 2016 (the WM performance information is no longer available). Active overseas equity managers had actually lost 0.7% p.a. over the same period. Relative performance will vary over time – similar statistics from 5 years ago show a 10 year track record of no added

value from UK equity managers but 1.2% p.a. outperformance from overseas managers. However, the average active manager has not added value over time. This is borne out by regular industry surveys, including the recent FCA review on the asset management industry. The key requirement therefore is the ability to identify in advance an above-average manager.

We believe there is a role for an allocation to passive equities as part of an overall equity allocation which is reflected in our own equity beliefs (included in Appendix 3). This is due to the low risk, low fee benefits. Active management should only be considered where the Committee believes it can add value. Where active management is employed, we have a preference for high-conviction mandates investing on a global basis to exploit the widest opportunity set to add value. For a number of other asset classes, active investment is currently the only viable investment option, for example, property, private equity and private debt.

The Fund has recently experienced a mixed time with its active equity managers: Nomura's far east mandate is down 1.5% relative to benchmark over 12 months but 0.9% p.a. ahead over 3 years and 0.1% since inception. This is below their performance target of 1.5% ahead of the benchmark.

In emerging markets, the Fund has had a mixed experience, with the JPM mandate down -3.8% over 12 months but the Schroders mandate ahead +2.5%. Both mandates are ahead of the benchmark since inception (by 0.3% p.a. and 2.4% p.a. respectively). Only Schroders appear to have achieved their performance target of 2% ahead of the benchmark. The Committee may wish to review the Nomura and JPM mandates given poor longer term performance or look to revisit the fees currently being paid, set out in the table below. Alternative options may also be available through LGPS Central.

**Table 8: Active equity management fees**

| Mandate | Management fee |
|---|---|
| **Nomura far east** | 0.50% p.a. on first £25m<br>0.40% p.a. on next £50m<br>0.35% p.a. thereafter |
| **JPM emerging markets** | 0.65% p.a. on first £50m<br>0.60% p.a. on next £30m<br>0.55% p.a. thereafter |
| **Schroders emerging markets** | 0.95% p.a. on first £50m<br>0.75% p.a. on next £50m<br>0.65% p.a. thereafter |

### Other assets

We believe that the Fund's corporate bonds could be passively managed. Passively managing these assets would generate some economies, including reducing the governance burden associated with the mandates and reducing the investment management fees. Our preference for passive management over active is based on the belief that active managers in assets such as corporate bonds do not add enough value in terms of returns in excess of the benchmark. Our view extends to the management of gilts and index linked gilts, to which new allocations are considered under strategy 4.

We acknowledge that corporate bonds and gilts represent a relatively small allocation within the current and alternative structures considered. However, if the Central Pool is to offer a passive investment grade credit fund, we would favour transferring the current allocation into a passive approach. The modelling carried out makes no allowance for active management and so a switch from active to passive management would not have an adverse impact on the expected returns shown earlier.

As mentioned above, new allocations to multi asset credit or private debt will need to be implemented via an active approach, due to the nature of these asset classes and lack of investible index to track.

### Our view

The overall split between active and passive management for those assets where both approaches are possible will depend on the Committee's beliefs in the ability of active management to add value. As per the above, we propose considering moving the corporate bond allocation to a passive approach.

### Style exposure

Just over half of the Fund's equities are managed on a passive market capitalisation weighted index tracking basis. A capitalisation-weighted index applies weights according to the total market value of the constituent companies' outstanding shares. There are several positive attributes to a market cap index tracking approach:

- Management fees are low, generally at 0.10% p.a or less;
- The overwhelming majority of managers use market cap indices as benchmarks resulting in high levels of liquidity and correspondingly lower transaction costs for market cap index tracking funds;
- Market cap index funds generally require less rebalancing due to index construction - the indices are, to a large degree, self-rebalancing. The index stock weights move in tandem with the market prices, negating the need for buying and selling shares; and
- Index tracking managers do need to deal with events such as rights issues, new entrants to and departures from the index and taxation issues; however, this is a relatively simple and predictable task, and is often where tracking managers can add marginal value.

The major criticism for price led index construction is that it has a pro-cyclical nature. As a stock's price increases relative to other index constituents, so does its weight in the index and vice versa. If companies' share prices accurately reflect their underlying financial performance then market cap weighted indices are behaving efficiently. However, stock prices are very erratic, driven by short term news and investors' behavioural drivers. There is much evidence to suggest that, even over extended periods, the relationship between share price and underlying fundamental value breaks down.

We believe that passively managed market-cap weighted equity investment has an anchor role to play in most pension schemes' equity allocations, reducing average fee levels. However, market-cap weighted indices do have their drawbacks. The passive acceptance of market prices implicit in market cap weightings means that opportunities to exploit the many opportunities when markets overshoot or undershoot fundamental value is missed. We believe (as set out in our equity beliefs) there is evidence to suggest that an appropriately constructed portfolio of factor tilts can provide a more efficient way of investing, net of fees and costs, than a market cap index.

For example:

- Exposure to "valuation factors" can improve risk adjusted returns over time. Even if outweighed by technical factors in the short-term, diversified exposure to valuation based factor tilts can add excess return per unit of risk over a reasonable timeframe;

- Exposure to the “low volatility factor” can reduce absolute equity volatility and improve risk-adjusted returns. Strategies can be implemented which manage downside risk while achieving market returns over time;

A factor-based approach is based on using specific characteristics (‘factors’) to construct benchmarks with the aim of generating a more attractive risk and return profile. Four common factors are described below. The Fund already has exposure to a number of these alternative passive equity approaches through a multi-factor mandate managed by L&G.

- **Value** - The value factor targets companies whose share price is deemed to be lower than the fundamentals of the company would suggest. The argument for the existence of a value premium is that investors on average overestimate how long stocks can sustain high growth and therefore under-price those stocks seen as low-growth.

- **Low volatility** – Some studies suggest that stocks with lower risk, due for example to the stability of the company, earn higher risk-adjusted returns. The behavioural argument is that investors’ desire to share in the possibility of high returns from high-risk stocks lead them to be overpriced on average.

- **Smaller stocks –** Smaller companies tend to be ignored by many investors. It is argued that this lack of attention, as well as their lower liquidity, creates a premium for smaller stocks.

- **Quality** – What constitutes ‘quality’ is less well defined than other factors, but, as a rule, high-quality companies are typically either highly profitable or are conservatively managed. The general argument for the existence of a quality premium is that investors tend to underestimate the ability of some companies to produce stable growth over the long term.

### Our view

We like the Fund’s allocations to factor tilted equity strategies. There is an ongoing debate about the existence, size and sustainability of these various risk premiums and therefore investment beliefs are often key in determining which approaches are favoured. The decision to allocate c75% of the overall equity allocation to passive market cap along with a multi factor mandate is evidence that the Committee believes a factor-based approach has potential to enhance the expected returns from a market cap approach and deliver a less volatile return series. The decision to allocate between different equity styles indicates caution over risk concentration with a particular style.

The Committee could consider whether the split between market cap and multi-factor remains appropriate and whether the allocation to market cap could be reduced in favour of multi-factor. In the previous section of the report we did not assume any significant variations in how equity market returns are modelled depending on the management style or the regional allocation.

The Committee will need to engage with the Central pool to understand what equity style options will be offered within the pool.

# 9 Interest rate and inflation hedging

The Fund's liabilities are linked to inflation and, depending on the valuation approach, changes in interest rates. One approach to meeting liabilities is therefore to buy assets which match the expected liability payments or have the same sensitivity to changes in interest rates and inflation. The downside of this approach is that the matching assets, such as index-linked gilts, are expensive. The Fund Actuary previously provided a funding illustration showing that if the Fund solely invested in matching assets, or a minimum risk portfolio, this would result in a funding level in the region of 50%.

In the structure modelling analysis in sections 2 and 3 we showed that yield risk, the potential funding impact from movements in interest rates and inflation, was almost half of the overall risk. However, as commented in that section much of this risk is 'mark to market' focussed rather than a real risk. Inflation is a real risk in that it directly impacts the value of member benefits but again there are two parts to this, one is realised inflation year-on-year while the other is pricing of future inflation (reflected in gilt pricing) which can be impacted by factors such as supply and demand. It is year-on-year inflation that impacts benefits while inflation pricing will have an impact through actuarial valuations.

### Should the Fund seek to hedge interest rate and inflation risk

The question on hedging for LGPS funds again comes back to objectives and the diagram in section 5. Hedging out risks can help with requirement 1 (reducing the chance of deficit increasing) as it can help to reduce the volatility of the funding level. However, if hedging is funded from other assets this might impact on assumed returns and also impact the deficit. It also has the potential to impact on requirement 2 (affordability of future benefits) as expected returns on matching hedging assets are lower than equities. There are other ways of hedging the risks through derivative solutions or by introducing leverage but we would again return to objectives.

To achieve the primary objective of paying member benefits and keeping them affordable, the Fund needs to generate long term real returns. The focus to date has been to invest primarily in equities which are expected to generate returns in excess of inflation, albeit they can be volatile in the short term. The focus has therefore been to try and maintain returns but smooth out the risk profile through diversification of risks.

We believe that this approach of targeting long term real returns, and diversifying the risks within the fund, remains appropriate. If it is affordable to do so then the Fund could seek to invest in matching assets as outlined in sections 3 and 5, subject to this being affordable from a funding and contribution rate perspective.

Where we do think hedging strategies are particularly relevant, is when seeking to manage specific employer risks. At present the Fund has a single investment strategy for all employers. We are now seeing a number of funds in the LGPS focus more on specific employers and the different objectives and risks they have. For example this can include employers working toward cessation or pools of well funded closed employers where either they are not required to take the same level of risk or they are looking to manage short term risk closely as they work towards a crystallisation event like cessation. This is something the Committee may wish to revisit in future.

### Managing inflation risk

One challenge to managing inflation risk for LGPS funds is that the benefits are now linked to CPI. At present there are very few assets with CPI linkage providing a direct link to CPI returns but also the pricing of CPI itself. The standard approach has therefore been to value and match inflation risk through RPI linked assets with a suitable adjustment for the difference in CPI and RPI. This means that until CPI linked assets are available there will always be an element of basis risk.

Another concern that has recently arisen is the potential treatment of RPI. The House of Lords recently published their report into the use of RPI which concluded that the Statistics Authority should try to fix the issue with clothes prices being included in the calculation of RPI and resume regular methodological improvements. They also reported that the government should agree to a single measure of inflation within five years to be used wherever possible. The House of Lords report increases the possibility that the RPI methodology could be changed in a way that is detrimental to holders of RPI-linked bonds and swaps, most likely to remove the upward bias of 0.30% p.a. caused by the 2010 change to clothing price collection.

The gilt and swap markets are taking that possibility seriously, with the level of inflation implied by those markets falling by c. 0.10% following the publication of the report. There remains significant uncertainty as to what happens next and when, any changes are not likely to be soon, but the report increases the momentum towards issuance of CPI or CPIH linked gilts.

We would therefore be cautious of putting inflation hedging in place ahead of the potential availability of CPI-linked government bonds and the potential impact on existing RPI linked assets or hedging instruments.

### Current gilt pricing

The charts below show the distribution of gilt yields over the last 5 years and also the yield position at 18 January 2019. We have shown real yields and the market implied level of RPI based on the difference in gilt and index-linked gilt yields.

**Chart 7: Real gilt yields**

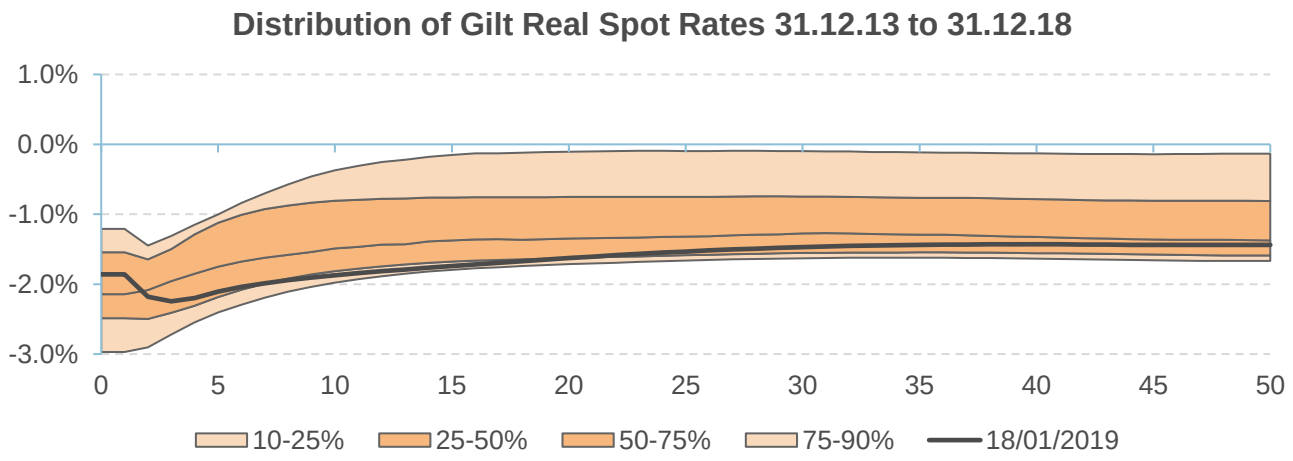
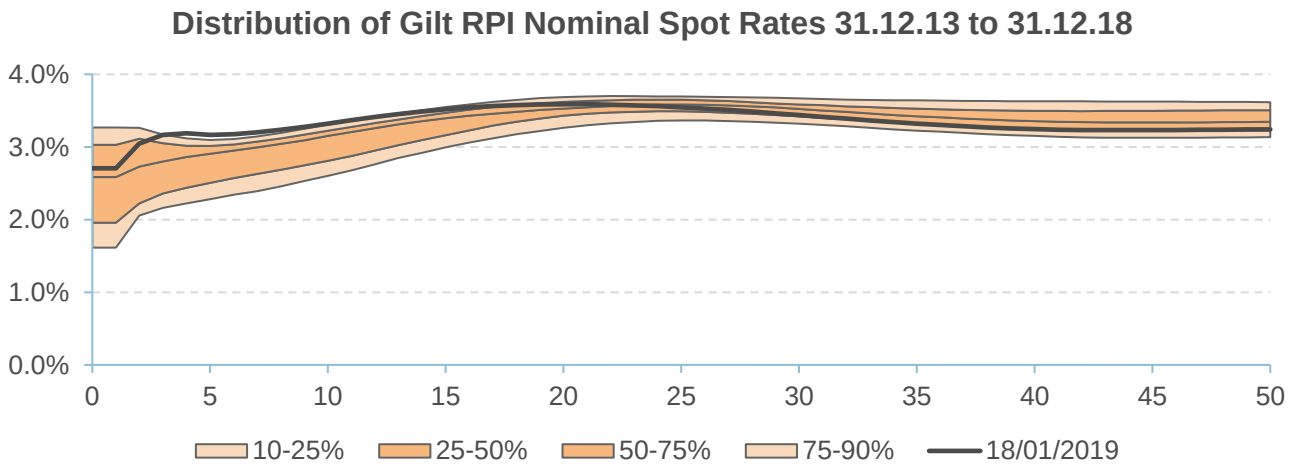



**Chart 8: market implied inflation – RPI**



The charts above show that real yields remain at extremely low levels due to a combination of the expectation of a continued low interest rate environment and the value investors place on inflation protection. Inflation protection is priced relatively attractively compared to where it has been in the last 5 years up to 20-25 years out but is still expensive longer term but as set out above there are some technical factors also impacting the potential attractiveness of inflation hedging given uncertainty over the future of RPI and RPI linked instruments.

### Summary

Interest rate and inflation risk can have a significant impact on the funding position and is an important risk consideration. However, this risk is partly a mark to market risk and should be considered in that context. Our preference would be for the Fund to focus on generating long term real returns and only consider hedging if looking at managing employer specific risks, or revisiting if there was an improvement in the pricing or outlook for index-linked gilts.

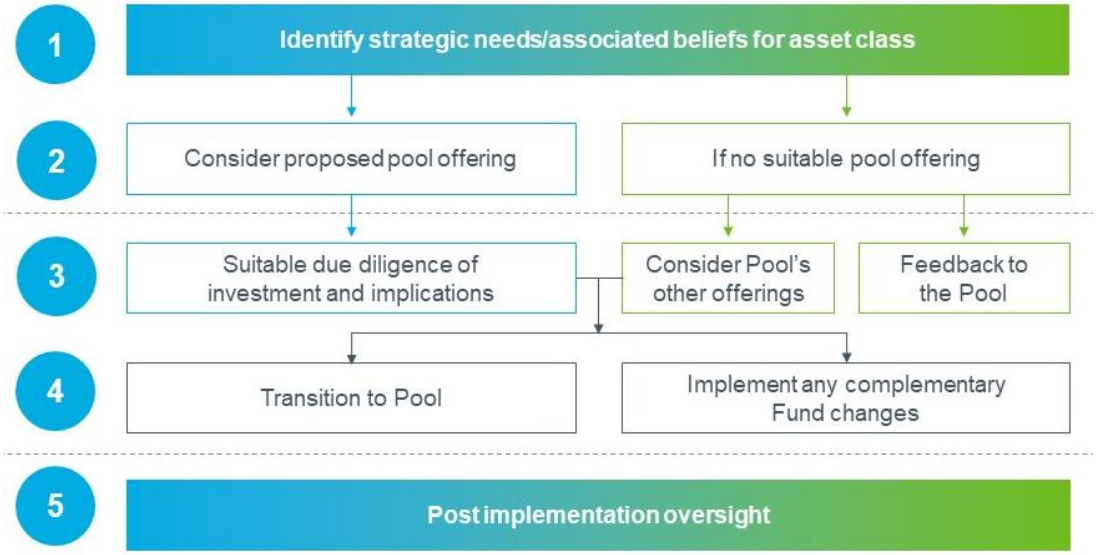
# 10 Investment Pooling – Mapping to LGPS Central Ltd

As demonstrated by the new guidance on pooling which is currently under consultation the focus on investment pooling and the pace of transition is if anything likely to increase over the next couple of years. When reviewing the strategic asset allocation it is therefore important that the ability to map the existing strategy across to the LGPS Central investment options is considered and any issues are identified to help with engagement and to prioritise the development of any new solutions that the Fund requires.

### Process of mapping to the Pool

Our approach to mapping is built around the framework below.

## Decision-making process




**Stage 1:** The Fund's investment strategy is the key driver of future returns (evidence shows investment strategy can contribute up to 90% of a scheme's total return). The mapping process is the "bridge" between the Committee's strategy (driven by objectives and beliefs) and the actual assets held (which will be managed by the Pool) and therefore Stage 1 is a fundamental part of the Fund's move into the Pool.

Given the importance of Stage 1, we recommend strongly that the Fund feeds into the Central Pool when considering its sub-fund range e.g. the nature/design of these sub-funds, to ensure the Fund's investment beliefs can be reflected in the investment strategy.

**Stages 2 and 3:**
When considering the Pool's existing sub-funds, we focus on the following questions:

- Does the sub-fund range allow the Fund to replicate the existing exposure? If it does (and the fund wishes to retain this exposure) we then move to the due diligence stage.
- Does the sub-fund range create opportunities not previously available? Examples tend to be smaller funds that have previously used DGFs which, due to the efficiencies from pooling, could now access alternatives more efficiently. Given the Fund's scale, this may be less of a factor.
- What gaps continue to exist in the sub-fund range that prevent the Fund's strategy from being implemented in full? Is the Pool planning to fill these gaps? If so, when?

- If options are viewed as suboptimal from a strategic perspective agree how best to engage the Pool to address this?

Once there is comfort with Stages 1-3, focus should move on to Stages 4 and 5, the transition process and ensuring there is suitable oversight of the Pool's approach to managing the Fund's assets. These are extremely important aspects of pooling.

The pooling process is likely to take time and the mapping aspect is a fundamental part of this process.

### Initial thoughts on mapping of strategic allocation

In the table below we set out our initial thoughts on the potential to map existing asset across the LGPS Central and potential opportunities to access new investment solutions. Please note these are initial high level views and further consideration and due diligence would be required before any transition of assets.

| Asset allocation | Mapping potential to LGPS Central |
|---|---|
| Active equity | The Pool will shortly be launching an active emerging market equity solution. This should be reviewed against the existing strategic objectives for the Schroder and JP Morgan mandates and the framework above with a view to switching existing assets into the Pool. The bespoke nature of the Nomura Asian equity mandate means that the Pool is not likely to offer an equivalent in the near term. |
| Passive equity | The Fund is currently benefiting from collectively negotiated fee terms with LGIM. The Pool currently offers a passive UK equity solution and passive Global solution in an ACS structure. There is an opportunity to review the UK allocation based on transition costs, running costs and RI options. The global solution is not a direct fit for existing allocations so would require greater strategic discussions on suitability. |
| Factor based equity | The Fund employs a mix of factor based approaches combining value, low volatility and quality biases and a rebalancing premium. The Pool offers a factor based solution focussed on diivdend growth. Given this is not a direct mapping strategic discussions on suitability would be required. |
| Structured equity | The Fund benefits from pool negotiated terms. We understand the Fund has received advice from the Pool on structured equity but the bespoke nature of the mandate means this would need to be maintained outside the Pool for now. |
| Property | The Fund has quite a bespoke portolio comprising open and closed ended core and specialist funds. We understand the Pool is still considering how to incorporate legacy assets and design a solution to meet client needs. In the short term the Fund should continue to develop the existing allocation while engaging with the Pool to help design an apprioriate solution. |
| Infrastructure | Similar to property the Fund has a mix of closed ended solutions investing across a range of infrastructure regions and segments. No clear mapping is available to the Pool yet. There is opportunity to wait for closed ended funds to mature and consider new commitment needs. The potential LGPS Central solution is currerntly in the design stage and is focussed on a CPI +3% return target |
| Private debt | The Fund has only a small allocation to private debt at the moment. The Pool is still in the design stage but we understand there is client demand so this is a good opportunity to engage with the Pool if seeking to commit further capital to this asset class. |

| Asset allocation | Mapping potential to LGPS Central |
|---|---|
| Multi-asset credit | No existing Fund allocation. Pool solution being designed and aiming for launch later this year. Opportunity to engage with Pool to shape strategic focus of solution. |
| Corporate bonds | The Pool corporate bond fund will be launched shortly with an active +0.80% target and 50% UK 50% Overseas benchmark. Potential strategic fit but some change required from existing allocation so suitability would need to be reviewed. |

In addition to the comments above we would note that the new draft guidance on pooling currently under consultation may impact the views on pooling options and the timeframes for both moving assets and investing in new opportunities. For example, for retained assets outside the Pool there will be a need to compare options and justify why they are being kept as a retained asset. This may be straightforward where no equivalent is available such as property but harder in cases like UK or Emerging market equity.

### Summary

In respect of the move toward investment pooling our initial views, based on the current strategy and options offered by LGPS Central, are as follows:

- The Committee should apply a consistent framework in assessing pooling options as set out in this section of the report.. This will assist in supporting any residual retained assets and the justifications required for reporting in the Investment Strategy Statement.
- We believe there are immediate options to consider mapping existing allocations into LGPS Central for passive UK Equities and active Emerging market equities.
- Further strategic considerations are required for allocations such as the remainder of the equity allocation including passive equities ex UK, active Asian equity and factor based equities and also corporate bonds if a passive alternative is not preferred. In our view the available equity options do not meet the strategic objectives of the Fund and therefore greater engagement with the Pool is needed.
- The Fund should look to engage with the Pool regarding solutions still in development or where no equivalent options are available for existing Fund allocations. This would include property, infrastructure, private debt and multi-asset credit.

# 11 Investment beliefs

### Why beliefs are important

Beliefs are, by definition, unique to each pension committee or trustee body. They reflect the way in which committees (explicitly or implicitly) translate a fund's objectives into its actual investment arrangements. For example, you can have two funds, with broadly similar characteristics and objectives, but very different investment arrangements e.g. the extent of their use of diversification, active and passive management, regional equity exposures, approach to environmental, social and governance matters etc. all because the committees' beliefs are very different.

Having a well-defined set of investment beliefs offers a number of advantages, including:

**Clarity of why each mandate is held and the role it performs in the Fund's arrangements** – this clarity is of benefit to committees and the underlying members. It also offers a basis for framing external communication on investment strategy which is of particular relevance where decisions are subject to public scrutiny.

**Prioritisation** - having identified which investment decisions are most important, advice can be sought and meetings scheduled around these key priorities.

**Long-term thinking** - having a set of stated beliefs, committees are better able to avoid being unduly influenced by short-term market noise and "fads".

**Consistency, both of advice and decision-making** – meaning all decisions are reached using the same consistent framework.

**Continuity of understanding in decision-making** – having a decision making framework based on a set of beliefs allows decisions to be contextualised which is particularly valuable if there is regular turnover of committee members, i.e. the committee may not "own" the decision on a certain element of the investment strategy, but as they own the framework, they can better understand why the decision was taken.

There is no right answer when it comes to setting beliefs, with each scheme's beliefs being unique, depending on their specific circumstances and their Committee's views. A scheme's beliefs should be revisited on a regular basis to ensure they remain appropriate. It is also important that these beliefs are reflected in the underlying portfolio of assets and in the scheme's ways of working.

The Fund has already developed a set of investment beliefs which we have included in appendix X. We believe it is important that these are tested and applied as part of any investment decision process.

### Testing strategy against beliefs

In this report we have covered a number of areas and potential amendments to investment strategy. Each of these should be tested against the investment beliefs to ensure they are consistent with the Committee's thinking about investment decision making. The areas for consideration include:

We discuss potential reductions in the equity allocation with a view to increasing the level of diversification

We discuss the use of structured equity which has a bearing on views to equity investing, risk management and the timeframe of setting an testing objectives

We discuss the use of active and passive management. Do the current beliefs accurately reflect the way the Fund currently invests and is there any impact from the recommendations in this paper

We discuss risk management options in areas including currency risk and interest rate and inflation risk.

We discuss meeting cashflow requirements and policies for realising cash when required

We also discuss the process of mapping assets into the pool and how best to engage with the pool, how does the pool governance and the engagement of the Fund with the pool compare to the Fund's beliefs on organisational beliefs

**Summary**

We are supportive of the Committee's development of a core set of investment beliefs as a framework for decision making. We believe that any investment decision should be tested against these beliefs including the conclusions and recommendations from this paper to ensure there is a robust process for testing potential changes in strategy that can stand up to scrutiny and can be clearly explained to external parties or new members of Committee.

# Appendix 1 – Structure model reliances and limitations

### Modelling

The modelling used calculates the estimated market risk and return characteristics of different portfolios against liabilities that are proxied by a combination of cash, fixed and index linked gilts under typical market conditions. It does not use liability cash flows and cannot accommodate accrual or contributions. Risk and return are described only at a summary level and the model cannot be used to drill down into how certain risks might manifest. This model cannot be used to explore long term funding risks and recovery plans.

The model is not in any way intended to be predictive of portfolio returns. Returns are presented as the median of 5,000 projected simulations of returns over the specified period. The risks are the specified-year volatilities (standard deviations) of the deficit divided by the value of the liability proxy at outset. The risk measure is therefore a balance sheet (mark to market or model) type measure and provides no indication of liquidity, cash flow matching, collateral adequacy or the other risks.

The attribution of risk is by considering the marginal impact on the overall volatility of the addition of a small allocation of the asset class (fund or mandate). The attributions therefore depend on the volatility of the asset class on its own, its correlation with other asset classes in the portfolio and the size of the allocations (before the notional marginal addition).

Unless otherwise stated, the structure model does not consider the asymmetric risks associated with any of the following types of investments/strategies:

•Financial options, such as interest rate swaptions and equity options.

•Non-rebalanced strategies - all investment strategies tested in the model are assumed to be rebalanced to the allocations input into the model.

•Impact of contributions on long term risk.

•Management actions taken by Committees (mechanistic, strategic or otherwise) around hedging, derisking, benefit changes, portfolio management and so on.

### Economic Scenario Service

The distributions of outcomes depend significantly on the Economic Scenario Service (ESS), our (proprietary) stochastic asset model. This type of model is known as an economic scenario generator and uses probability distributions to project a range of possible outcomes for the future behaviour of asset returns and economic variables. Some of the parameters of the model are dependent on the current state of financial markets and are updated each month (for example, the current level of equity market volatility) while other more subjective parameters do not change with different calibrations of the model.

Key subjective assumptions are the average excess equity return over the risk free asset, the volatility of equity returns and the level and volatility of yields, credit spreads, inflation and expected (breakeven) inflation, which affect the projected liability and bond returns. The output of the model is also affected by other more subtle effects, such as the correlations between economic and financial variables.

Our expectation (i.e. the average outcome) is that long term real interest rates will gradually rise from their current low levels. Higher long-term yields in the future will mean a lower value placed on liabilities and therefore our median projection will show, all other things being equal, an improvement in the current funding position (because of the mismatch between assets and liabilities). The mean reversion in yields also affects expected bond returns. The impact of the yield reversion assumption is illustrated in the standard results charts that we produce using the model output.

While the model allows for the possibility of scenarios that would be extreme by historical standards, including very significant downturns in equity markets, large systemic and structural dislocations are not captured by the model. Such events are unknowable in effect, magnitude and nature, meaning that the most extreme possibilities are not necessarily captured within the distributions of results.

Given the context of this modelling, we have not undertaken any sensitivity analysis to assess how different the results might be with alternative calibrations of the economic scenario generator.

The returns presented here are time weighted returns over the specified period and are unaffected by the timing of any contributions received or pensions paid over that period. Such returns are, in general, a poor estimator of money weighted returns, which are sensitive to the timing of cashflows.

The probability that a specific asset return will be exceeded will not usually equate to the probability that some funding plan based on this return will be sufficient to meet all the pension payments. Complex interactions between the assets, yields and cashflow timings can mean that the two probabilities are materially different, especially for more mature schemes.

The following figures have been calculated using 5,000 simulations of the Hymans Robertson Economic Scenario Service, calibrated using market data as at 31 December 2018. All returns are shown net of fees. Percentiles refer to percentiles of the 5,000 simulations and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the (simulated) yields in force at that time horizon.

| | | Annualised total returns | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Cash | Index Linked Gilts (medium) | Fixed Interest Gilts (medium) | UK Equity | Overseas Equity | Property | CorpMedium A | Inflation | 17 year real yield | 17 year yield |
| 5 years | 16th %'ile | -0.2% | -2.1% | -2.6% | -4.2% | -4.0% | -3.3% | -2.2% | 1.6% | -2.3% | 1.0% |
| | 50th %'ile | 0.9% | 0.7% | 0.5% | 4.2% | 4.3% | 2.6% | 1.3% | 3.1% | -1.4% | 2.3% |
| | 84th %'ile | 2.2% | 3.5% | 3.6% | 13.2% | 13.0% | 9.0% | 4.5% | 4.7% | -0.5% | 3.9% |
| 10 years | 16th %'ile | 0.0% | -1.4% | -0.9% | -1.2% | -1.1% | -1.3% | -0.4% | 1.8% | -1.8% | 1.4% |
| | 50th %'ile | 1.5% | 0.4% | 0.6% | 4.9% | 5.0% | 3.4% | 1.4% | 3.2% | -0.6% | 3.0% |
| | 84th %'ile | 3.2% | 2.3% | 2.0% | 11.3% | 11.1% | 8.0% | 3.0% | 4.8% | 0.6% | 5.0% |
| 20 years | 16th %'ile | 0.9% | -0.7% | 0.5% | 1.4% | 1.5% | 0.8% | 1.1% | 2.0% | -0.7% | 2.2% |
| | 50th %'ile | 2.6% | 0.7% | 1.4% | 5.9% | 6.0% | 4.5% | 2.3% | 3.2% | 0.8% | 4.0% |
| | 84th %'ile | 4.6% | 2.4% | 2.3% | 10.6% | 10.6% | 8.3% | 3.5% | 4.7% | 2.3% | 6.3% |
| | Volatility (Disp) (1 yr) | 1% | 7% | 10% | 19% | 19% | 14% | 10% | 1% | | |

The current calibration of the model indicates that a period of outward yield movement is expected. For example, over the next 20 years our model expects the 17 year maturity annualised real (nominal) interest rate to rise from -1.8% (1.8%) to 0.8% (4.0%)

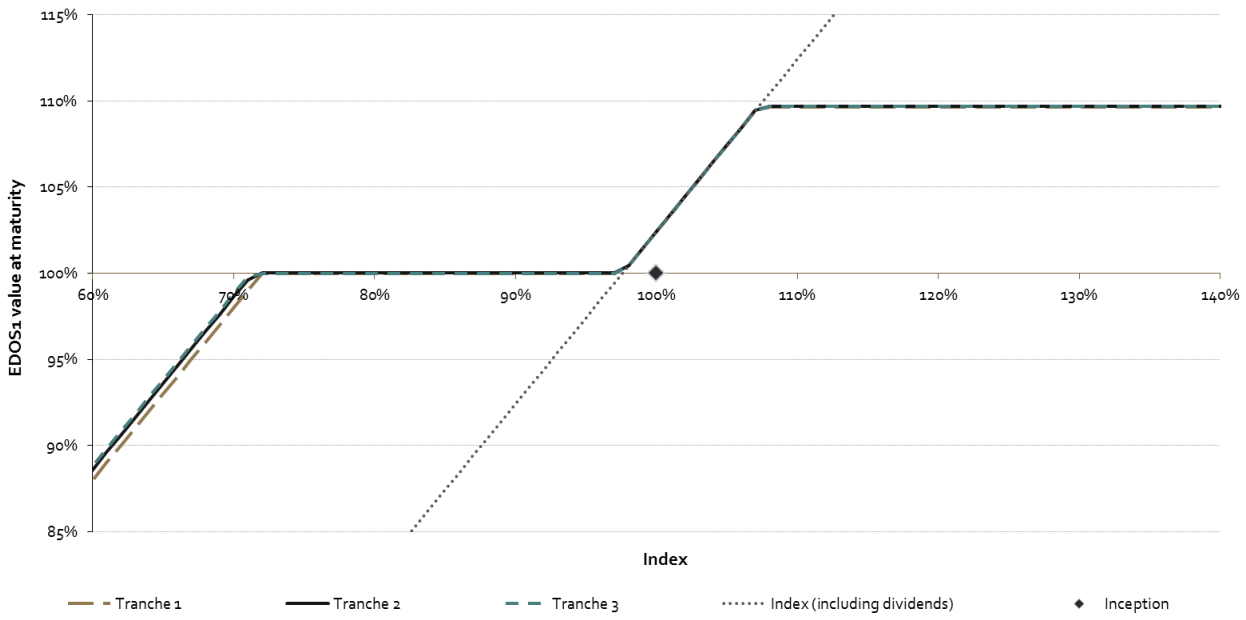
### Modelling liabilities

We model scheme liabilities approximately by assuming that real and fixed liabilities can be represented by long dated inflation linked and fixed interest gilts respectively. It is possible that the proxy liabilities mis-state the true sensitivity of the scheme liabilities to changes in interest rates and inflation.

# Appendix 2 – Structured equity pay-off profiles

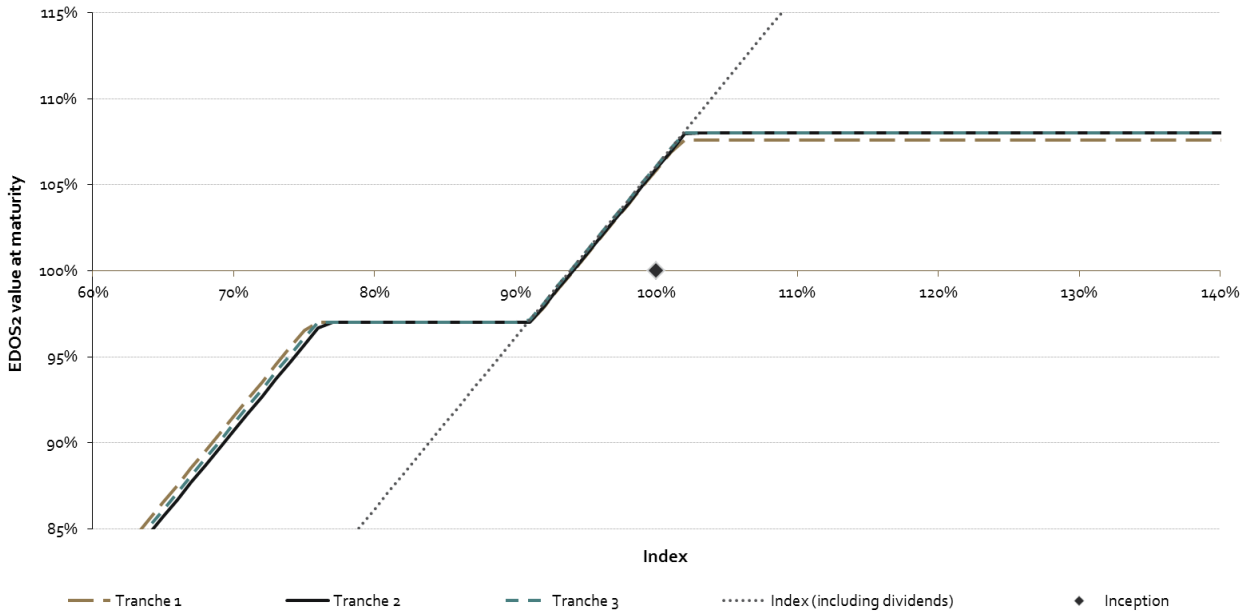
The following charts set out the pay-off profiles of the Sections of the structured equity solutions at expiry. We would note that the payoff profile will look different if liquidated before expiry.

## EDOS1



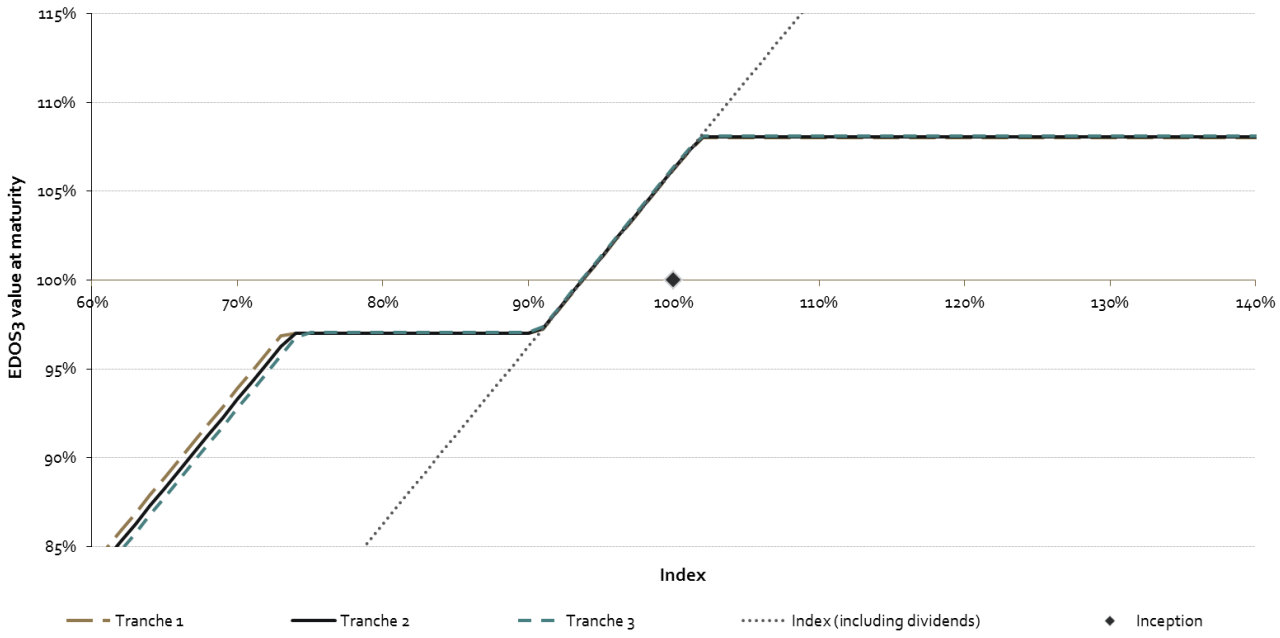

Source: River and Mercantile Derivatives

## EDOS2



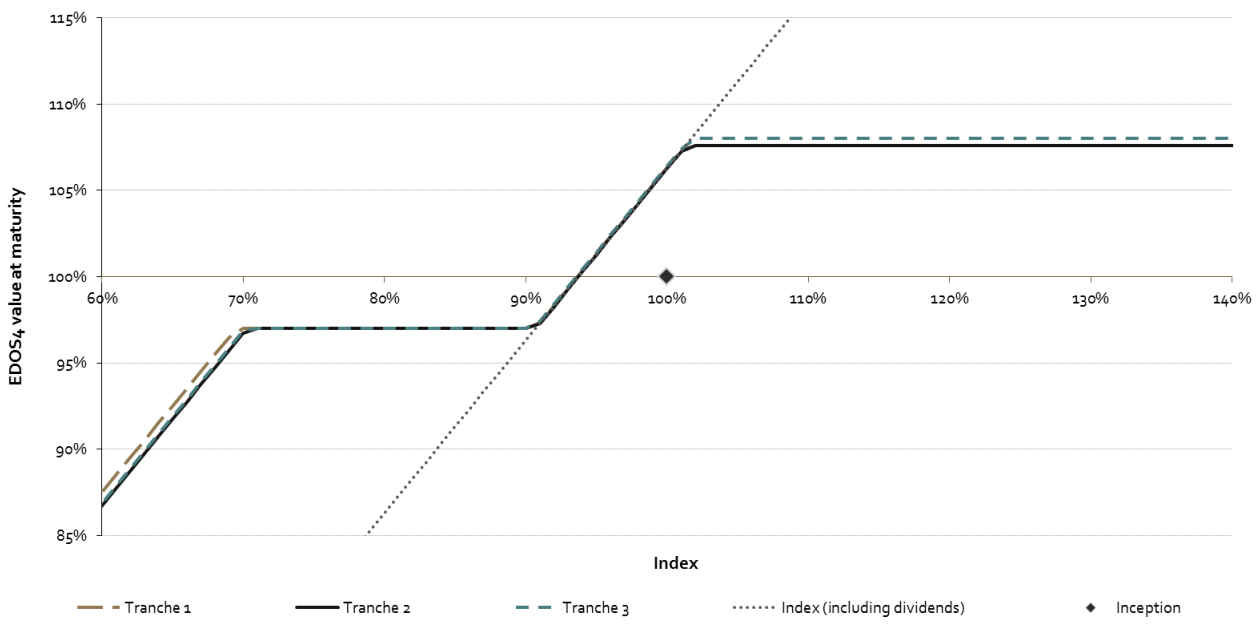

Source: River and Mercantile Derivatives

## EDOS3




Source: River and Mercantile Derivatives

## EDOS4




Source: River and Mercantile Derivatives

# Appendix 3 - Equity beliefs

**Investment Beliefs: Listed Equity**

1. Passively managed market cap based investment has a balancing role to play in most pension schemes' equity allocations, bringing liquidity, transparency and reducing average fee levels;
2. Market cap weighted indices have their drawbacks; adding carefully selected systematic, factor tilted equity strategies can improve risk-adjusted returns, benefiting from disciplined rebalancing (the "rebalancing premium");
    - Exposure to "valuation factors" can improve risk adjusted returns over time. Even if outweighed by technical factors in the short-term, diversified exposure to valuation based factor tilts can add excess return per unit of risk over a reasonable timeframe;
    - Exposure to the "low volatility factor" can reduce absolute equity volatility and improve risk-adjusted returns. Strategies can be implemented which manage downside risk while achieving market returns over time;
    - Exposure to the "small size factor" can improve risk-adjusted returns. A diversified tilt towards medium and smaller sized businesses is generally rewarded over time;
    - Carefully selected exposure to actively managed growth strategies can improve the balance of overall equity exposure and improve risk adjusted returns;
3. Exposure to emerging markets provides diversification and the opportunity for higher returns due to the higher risk premium typically earned for investing in these markets;
4. With sufficient research and governance, active equity management can be incorporated to add value relative to market cap weighted indices; overall active equity exposure should be focused predominantly on stock-specific risk;
5. Currency exposure associated with investing in equities can add volatility. Whilst it can be desirable to retain exposure to some currencies, hedging a proportion of non-domestic currency exposure can reduce the volatility of equity investing;

# Appendix 4 - WCCPF – Investment beliefs

## Statement of Investment Beliefs from ISS

The Fund's investment beliefs outline key aspects of how it sets and manages the Fund's exposures to investment risk. They are as follows:

**Financial Market Beliefs**

- There exists a relationship between the level of investment risk taken and the rate of expected investment return. As taking calculated risks does not guarantee returns, investment losses or below expected returns are possible outcomes.
- Markets are dynamic and are not always efficient, and therefore offer opportunities for skilled active managers.
- In making investments in illiquid assets, a return premium should be sought.
- Diversification is a key technique available to institutional investors for improving risk-adjusted returns.
- The fund believes that investing for the long term can add value to the fund as it allows the fund manager to focus on long term value and use short term volatility to establish favourable investments.
- Where an asset class/strategy is not expected to help in delivering the risk adjusted investment return required it should not be held.

**Investment Strategy/Process Beliefs**

Clear investment objectives are essential. Return and risk should be considered relative to the Fund's liabilities, funding position and contribution strategy.

Risk should be viewed both qualitatively and quantitatively. Particular focus should be given to the risk of loss and also to the nature and likelihood of extreme events so that the Fund is not a forced seller of assets.

- Strategic asset allocation is a key determinant of risk and return, and thus is typically more important than manager or stock selection.
- Equities are expected to generate superior long-term returns relative to Government bonds.
- Alternative asset class investments are designed to further diversify the portfolio and improve its risk-return characteristics.
- Active management can add value over time but it is not guaranteed and can be hard to access. Where generating 'alpha' is particularly difficult, passive management is preferred.
- Operational, counterparty, conflicts of interest and reputational risk need assessment and management, in addition to investment risk.
- Concentrated portfolios (smaller numbers of holdings or less external managers) allow for greater investment focus, lower investment costs and enable more focused engagement with Responsible investment.
- Managing fees and costs matter especially in low-return environments. Fee arrangements with our fund managers – as well as the remuneration policies of investee companies – should be aligned with the Fund's long-term interests.

**Organisational Beliefs**

- Effective governance and decision-making structures that promote decisiveness, efficiency and accountability are effective and add value to the Fund.
- When outperformance of a desired benchmark is not possible the fund will use index funds, financial instruments or proxies (Investments that share similar characteristics) to gain exposure to the asset class in the most cost effective way.
- Investment costs are necessary to generate outperformance in asset classes where outperformance is achievable. Investment costs are a certain cost that should be fully transparent and managed by the operator in the best interests of the pension Fund.

**Responsible Investment Beliefs**

- Effective management of financially material ESG risks should support the Fund's requirement to protect returns over the long term.
- Investee companies with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events.
- There are some investment opportunities arising from environmental and social challenges which can be captured so long as they are aligned with the Fund's investment objectives and strategy.
- Responsible Investment should be integrated into the Investment process.
- The Fund will manage Responsible Investment factors through engagement rather than exclusions.

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**AGENDA ITEM 6**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# LGPS CENTRAL UPDATE

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**Recommendation**

1. **The Chief Financial Officer recommends that the LGPS Central Update and presentation provided at the meeting be noted.**

## Update

**Presentation**

2. Mike Weston the LGPS Central Chief executive and Joanne Segars Chair of LGPS Central are attending the Committee and will be providing a presentation covering key aspects of the company.

**Transition of Assets and Stakeholders day**

3. A stakeholder event was provided by LGPS Central on 17 February 2019. All pension committee members, investment consultants and relevant officers of the partner funds were invited to the event. This was well attended and a product information presentation relating to the active Global emerging markets was also provided with the opportunity to question the 3 individual investment managers who had been appointed.

4. The next fund to transition across after Global equities is the Emerging Markets active equities. Worcestershire currently has mandates with JP Morgan and Schroder's. This has been detailed in the Pension Investment update earlier on the agenda together with details of the transition after this which will be Corporate Bonds. Regular updates will be provided to Committee and there will be a similar product information day for Corporate Bonds as there was with Emerging Markets.

**LGPS Central Budget and Business Plan 2019/20 Cost Sharing Agreement**

5. The Committee was presented with the draft versions of the 2019/20 LGPS Central budget and business plan at its meeting on the 21 January 2019. This was thoroughly debated and the Fund's Stakeholder representative Councillor Hardman was asked to take the minuted views to the next Shareholders Forum meeting on 12 February 2019.

6. Councillor Hardman was also asked to address any significant changes to the Budget and Business Plan on its behalf in consultation with the Chairman and Vice-Chairman of the Committee. However, there were no significant changes to those reported to Committee.

7. The Budget and Business plan was discussed in detail at the Shareholders Forum on the 21 February and agreed later at the LGPS Company meeting where Shareholders expressed their views and expectations.

*Cost Sharing Implications*
8. The updated cost sharing model was also discussed at the Committee meeting on the 21 January 2019 which took on board an updated transition timetable and the estimated budget. The impact on Worcestershire to that reported in March 2017 was a reduction in the forecast cumulative saving of £3.4m up until 2033/34. The estimated savings are estimated to be £0.6m compared to the previous £4m that was forecast.

9. The main reason for the reduction in savings is the reclassification of certain costs when building up the 2018/19 budget. Worcestershire's cost allocation is particularly sensitive to increases in costs such as governance where the allocation is shared equally. It should be noted that the forecast assets under management and the timetable for product launches will need to be updated. The LGPSC business case will be rerun at various key stages over the next few years.

10. The cost sharing model is now being looked at by the Practitioners Advisory Fund Finance working group and their findings will be reported to a future Committee as soon as they are known.

*Staffing*
11. A new Chief Executive of LGPS Central, Mike Weston has been appointed and will start from the 5 March 2019.

*Client Agreements and Governance*
12. Considerable focus is still being placed on the client agreements that LGPS Central need to have in place as these are still outstanding.

13. There are regular individual partner fund meetings with the Head of Client Service and Stakeholder Engagement. LGPSC also provide detailed updates to the monthly Practitioner Advisory Forum (PAF) Meetings.

14. PAF have a number of Work streams which meet regularly and aims to work closely with LGPS Central to ensure that all the funds requirements are met. These work streams cover: Investments; Client Reporting; Finance; Responsible Investment; and Governance.

**Contact Points**

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Rob Wilson
Pensions Investment, Treasury Management & Capital strategy manager
Tel: 01905 846908
Email: RWilson2@worcestershire.gov.uk

**Background Papers**
In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

LGPS Central business case submission to government 15 July 2016.

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**AGENDA ITEM 7**

# PENSIONS COMMITTEE
# 19 MARCH 2018

# PENSIONS ADMINISTRATION STRATEGY

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**Recommendation**

1. **The Head of Human Resources and Organisational Development recommends that the 2019 Pensions Administration Strategy be approved.**

2. The aim of the Pensions Administration Strategy (PAS) are to:

   a) provide a high-quality pension service to members;
   b) set out the quality and performance standards expected of the Fund and its scheme employers; and
   c) promote good working relationships and improve efficiency between the Fund and its scheme employers.

3. The efficient delivery of the benefits of the scheme is reliant upon effective administrative procedures being in place between the Fund and scheme employers, most importantly the timely exchange of accurate information in relation to scheme members.

4. The Strategy sets out the expected levels of performance of the Fund and the scheme employers and these will be monitored and performance levels will be reported annually.

5. Consultation of the draft Strategy has been undertaken with all employers and the Pension Board and feedback has been included.

6. The Strategy will be effective immediately and the Fund will continue to keep the strategy and policy document under review and update as required to reflect changes in scheme regulations and Fund working practices.

**Contact Points**

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Bridget A Clark, HR Service Centre Manager
Tel: 01905 766215
Email: bclark@worcestershire.gov.uk

## Supporting Information

- Appendix - Pensions Administration Strategy

## Background Papers

In the opinion of the proper officer (in this case the Head of Human Resources and Organisational Development) there are no background papers relating to the subject matter of this report.

**Worcestershire Pension Fund Pension Administration Strategy**

## PREFACE

This Pension Administration Strategy has been produced to:

- Set out the Local Government Pension Scheme (LGPS) roles and responsibilities of Worcestershire Pension Fund and our employers.

- Establish the levels of performance we and our participating employers are expected to achieve in carrying out their responsibilities.

**Help us to help you:** to administer the LGPS on behalf of our employers, we as the Scheme Administrator need our employers (in a manner that is data secure) to do a number of things including:

1. Provide us with **one named lead contact / account manager** who will liaise with us on behalf of their organisation, co-ordinating delivery of all LGPS requirements across their whole organisation (i.e. Finance Manager, Human Resources representative, Business Manager, Chief Executive, Payroll representative, etc.).

2. Maintain and supply us with an **Employer's contacts at my organisation Excel spreadsheet** in the format shown in Appendix 1.

3. **Calculate, notify and deduct employee contributions** for each employee in the LGPS (using a unique pensions identifier number for each employment) in accordance with the LGPS HR Guide (see: http://www.lgpsregs.org/resources/guidesetc.php) and the annual update issued by the LGA every March (see http://www.lgpsregs.org/bulletinsetc/bulletins.php).

4. By the 19th of the month following the month of deduction **remit to us all contributions,** including employer contributions) at the appropriate rate for the LGPS scheme year in question.

5. **Remit to us any additional pension contributions (APCs)** relating to their employees.

6. **Remit to Scottish Widows any additional voluntary contributions (AVCs).**

7. **Allocate trained resources** to supply us within the required timescales with:

    a. The various pension administration forms and spreadsheets that we require for each life event that affects their employees.

    b. The various regular and ad hoc pay, service, contributions and personal information that we require for their employees.

8. **Publish and forward to us an up to date employer policy statement** for all employer discretions under the LGPS regulations.

9. Appoint an adjudicator to **handle appeals** in accordance with the LGPS regulations.

10. **Keep abreast of** the range of material we make available.

## CONTENTS



## CONTACT US

**Website:** http://www.worcestershire.gov.uk/pensions

**By email:** pensions@worcestershire.gov.uk

**By post:** Worcestershire Pension Fund, County Hall, Spetchley Road, Worcester, WR5 2NP

**By phone:** Find out who to contact

## 1. OUR RESPONSIBILITIES TO OUR EMPLOYERS AND MEMBERS

**Our general responsibilities:**

1. To comply with all relevant legislation and guidance (for example from The Pensions Regulator).

2. To apply the LGPS regulations in line with our Policy Statement on our LGPS discretions. NB we can recover costs from an employer where costs have been incurred because of that employer's level of performance in carrying out its functions.

3. To accurately record and update member records on the pension administration system.

4. To maintain a compliant website that provides stakeholders with a first port of call for all of their pensions information needs, so that they can make informed decisions. NB we will make it clear that we are not able to provide financial advice.

5. To invest in digitisation to maximise self-service for our members and employers.

6. To maintain an appropriate range of up to date forms and guides.

7. To produce newsletters for all members at least annually.

8. To provide guidance on the secure submission of data.

9. To chase up information that we have asked for.

10. To agree timescales for dealing with bulk work / queries.

11. To appoint and manage appropriate specialist professional services organisations.

12. To review the Pension Administration Strategy annually in consultation with employers.

**Governance – our responsibilities:**

1. To operate with a Pensions Committee and a Pension Board including employer and employee representatives.

2. To deliver appropriate training for the members of the Pensions Committee and Pension Board.

3. To maintain a Risk Register.

4. To produce, operate according to and maintain a Governance Policy Statement.

5. To report any failures to The Pensions Regulator / Scheme Advisory Board.

6. To deliver complaints and IDRP procedures.

7. To comply with any audit requirements / recommendations.

**Funding and investments – our responsibilities:**

1. To set out a clear and transparent Funding Strategy Statement and consult with employers on this.

2. To encourage employers to participate in annual covenant reviews to help us to manage risk.

3. To produce and maintain an Investment Strategy Statement.

4. To appoint and manage LGPS Central Limited and the Fund's other investment managers.

5. To monitor the performance of the Fund's assets.

6. To produce a Statement on Compliance with the UK Stewardship Code for Institutional Investors.

7. To produce Environmental Social and Governance (ESG) information.

**Financial and data obligations – our responsibilities:**

1. To allocate the contributions received correctly to each employee record.

2. To keep a log of contributions received from each employer.

3. To retain the right to charge interest at 7% for persistent and ongoing late payment in the following circumstances:

    a. If employer contributions (including deficit payment) are overdue (if they are not received a month later than the due date specified).
    b. If any other payments are overdue (if they are not received by the due date specified).

4. To pass on any fines levied by third parties arising from employer performance.

5. To inform each employer of any new contribution bandings table in place from each April.

6. To inform employers of any rechargeable items e.g. actuarial fees as they become due / at the end of financial year.

7. To produce an Annual Report / Statement of Accounts.

8. To manage admission agreements / the processes for admitting new employers, for whom an annual covenant review will be mandatory.

9. To manage the delivery of FRS / IAS information to employers.

10. To take account of covenant reviews in setting employer contribution rates.

11. To advise employers when strain costs / compensatory added years payments are due.

**Annual return, actuarial valuations when being undertaken and annual benefit statements – our responsibilities:**

1. To process employer year end contribution returns within 1 month of receipt i.e. 31 May.

2. To produce annual benefit statements (ABS) for all employee and deferred members by 31 August.

3. To highlight annually if a member has exceeded their annual allowance and issue a Pension Savings Statement by 6 October.

4. To provide data to the Fund Actuary and Governments Actuary's Department to enable employer contribution rates to be accurately determined.

5. To provide an electronic copy of the actuarial valuation report and contributions certificate to each employer.

**New starts – our responsibilities:**

1. To accurately create member records on the pension administration system within 40 working days of notification from an employer of a new entrant to the LGPS.

**Changes in circumstances for employee members – our responsibilities:**

1. To accurately record and update member records on the pensions administration systems within 10 working days of completed notification.

**Employee members – our responsibilities:**

1. To update employee members' career average revalued earnings (CARE) accounts for the annual revaluation on 1 April.

**Transfer in / out estimates – our responsibilities:**

1. To provide transfer in information to the member within 10 working days of all information required being received.

2. To provide transfer out information within 10 working days of all information required being received.

**Divorce estimates – our responsibilities:**

1. Where a request for divorce information including a cash equivalent transfer value (CETV) is received from the member, or the Court, we will provide the member with a schedule of our charges and then issue the estimate within 45 working days of the receipt of the signed request from the member / receipt of the Court order.

**Outsourcing estimates – our responsibilities:**

1. To provide guidance to and the estimated fees (these are likely to be at least £5,000) that will be incurred by current employers participating in the LGPS who are considering outsourcing.

**Actual retirements – our responsibilities:**

1. To issue individual quotations / information within 15 working days after all information required to process a quotation has been received.

2. To issue employee members with a letter notifying them of their actual retirement benefits within 15 working days following receipt of the completed Leavers Form.

3. To issue deferred members with a letter notifying them of their actual retirement benefits within 15 working days following receipt of all documentation from the member.

**Ill health retirements – our responsibilities:**

1. To calculate and pay the benefits within 15 working days following receipt of all documentation.

2. To assist employers in discharging their responsibility to review Tier 3 ill health cases at 18 months.

3. To assist employers to select an Independent Registered Medical Practitioner (IRMP).

**Members leaving employment before retirement – our responsibilities:**

1. To provide members with Opt Out forms and information about going 50/50, refunds / becoming deferred / transfers out.

2. To provide members becoming deferred with the options available to them within 30 working days of receipt of all the correct information from the employer via the Leavers Form.

3. To process and pay a refund within 10 working days to an eligible member following receipt of all relevant documentation.

**Deferred members – our responsibilities:**

1. To updated deferred members' benefits for the annual pensions increase award / annual CARE revaluation as appropriate.

2. To provide estimates of benefits that may be payable and any resulting employer costs within 15 working days of request.

3. To select an Independent Registered Medical Practitioner (IRMP).

**Death in service – our responsibilities:**

1. To provide an initial letter of acknowledgement to the next of kin / informant within 5 working days following a notification of death.

2. To provide a letter notifying dependents of benefits within 10 working days following receipt of identification / certificates and relevant documentation.

3. To assist employers, employees and their next of kin in understanding the options available to a member in serious ill health and expedite the payment of any benefits in an appropriate and caring manner.

**Additional voluntary contributions (AVCs), Additional Pension Contributions (APCs) and shared cost APCs (SCAPCs) – our responsibilities:**

1. To appoint and manage an in-house AVC provider.

2. To direct members / employers to information on these options as requested.

**Pensioners – our responsibilities:**

1. To make payment of any lump sum within a month of receipt of all relevant fully completed retirement forms and certificates from the member, or retirement date if later.

2. To pay pension payments on the last working day of each month following retirement, unless this falls on a weekend or bank holiday when the payment will be made on the last working day before.

3. To pay LGPS benefits to their qualifying dependents.

4. To obtain annual life certificates from certain members.

5. To pay Her Majesty's Revenue & Customs.

6. To increase pensions annually if appropriate.

7. To provide payslips / P60s.

**Complaints / adjudication of disagreements – our responsibilities:**

1. To appoint an adjudicator to deal with disagreements.

2. To acknowledge disagreements within 10 working days of receipt of the completed documentation.

3. To review and provide updates to the member in a timely manner.

4. To notify the employer of decisions and / or appeals as requested.

5. To listen sympathetically to complaints and respond to them within 10 days.

**Performance monitoring and reporting – our responsibilities:**

1. We will develop arrangements for reporting on key performance measures. This will provide a mechanism for service level review and recognition of best practice.

2. We will seek to work closely with employers to:

- Identify areas of poor performance.
- Provide the necessary training and development.
- To put in place appropriate processes to improve the level of service in the future.

**Reporting breaches – our responsibilities:**

1. To have procedures to be followed in relation to reporting breaches of the law to The Pensions Regulator.

## 2. EMPLOYERS' RESPONSIBILITIES

**Employers' general responsibilities:**

1. To make it clear that Worcestershire Pension Fund is not able to provide financial advice.

2. To be familiar with the HR and Payroll guides available at http://www.lgpsregs.org/resources/guidesetc.php

3. To provide us with up to date and correct information as and when requested in accordance with agreed timescales and the regulations.

4. For larger bulk estimates, to make requests via the spreadsheet template provided by us and to give us as much notice in advance, for example when any redundancy exercises are planned.

5. To operate controlled, authorised processes and procedures.

6. To familiarise themselves with our:
    a. Policy Statement on Communications.
    b. Funding Strategy Statement.
    c. Governance Compliance Policy.
    d. Investment Strategy Statement.

**Financial and data obligations - employer responsibilities:**

1. To calculate, collect and pay us no later than the 19th day of the month following the period of deductions:
    - All employee contributions deducted from payroll (excluding AVCs).
    - Employer contributions.
    - Any deficit lump sum payments due on a monthly basis.

2. To accompany each payment with the Payover Form PCF1.

3. To pay all rechargeable items to the Fund on receipt of the invoice within the timescales specified.

4. To provide us with accurate member data, using the monthly CARE spreadsheet.

**Annual return, actuarial valuations when being undertaken and annual benefit statements - employer responsibilities:**

1. To ensure we receive accurate year end information to 31 March through the Year End Spreadsheet by 30 April.

2. To submit accompanying paperwork detailing this together with payment or a formal request for a refund should there be any under / over payment discovered whilst reconciling.

3. To provide any additional information that may be requested to produce annual benefit statements for service up until 31 March in each particular year by the 30 April each year.

4. To ensure that all errors highlighted from the annual contribution and pensionable pay posting exercise are responded to and corrective action taken promptly.

**New starts - employer responsibilities:**

1. To ensure that pension information is included as part of any new employment induction process, in contracts of employment and appointment letters.

2. To ensure that all employees subject to contractual admissions are bought into the LGPS from their relevant start date.

3. To provide us with accurate new member data, using the New Starter Form / interface within 4 weeks or at the members' start date or within 14 days of the first time the new employee is included on the employer's payroll run.

4. To provide each new employee with a link to our Guide to the LGPS and a New Starter Form with their contract of employment.

5. To determine the appropriate contribution rate (whether individually or by an automated process on payroll) and as soon as is reasonably practicable, notify the employee of the contribution rate which is to be deducted from the employee's pensionable pay and the date from which the rate will become payable. It is for the employer to determine the method by which the notification is given to the employee, but the notification must contain a statement giving the address from which further information about the decision may be obtained. The notification must also notify the employee of the right to appeal, including the process and timescales involved. Furthermore, the correct employee contribution rate should be applied and (if appropriate) adjusted throughout the year according to the employer's Policy Statement on discretions.

**Important note:** Where there is more than one contract of employment with the same employer, each membership shall be maintained separately and notified to us as above.

**Changes in circumstances for employee members - employer responsibilities:**

1. To ensure that we are informed of any changes in the circumstances of employees, by completing the Employer Notification of Changes relating to Pensionable Employment Form / Leavers Form / Ill Health Form / 50:50 cancel form / 50:50 Option Form / etc. within 4 weeks of the change. Changes include:
    a. Name.
    b. Marital status.
    c. NI number.
    d. Contractual hours (for members who meet the underpin requirements only).
    e. Any remuneration changes due to promotion and down grading.
    f. Full time equivalent pensionable pay according to the pre 2014 definition.
    g. Actual pensionable pay (including overtime/additional hours) in 100/100 and 50/50 according to the post 2014 definition (CARE).
    h. Employee contribution rate.

i. Employee number and / or post number.
j. Date joined LGPS (if adjusted).
k. Confirmation of 50/50 or 100/100 entry.
l. Additional Voluntary Contributions (AVC) contributions.
m. Shared cost AVC contributions (if applicable).
n. Additional Pension Contributions (APC).
o. Notification of Flexible Retirement.

2. To apply assumed pensionable pay (APP) for pension purposes during periods of reduced or nil pay as a result of sickness, injury or relevant child related leave (i.e. ordinary maternity, paternity or adoption leave or paid shared parental leave and any paid additional maternity or adoption leave). **Important note:** If the employee receives no pay, employer contributions should still be paid.

3. To calculate and provide to the member the APP amount should an employee wish to purchase Additional Pension Contributions (APC) or a Shared Cost Additional Pension Contribution (SCAPC) contract to buy back the pension 'lost' during the absence, **Important note:** before a period of absence employers must bring to the attention of the employee that they can buy back the 'lost' pension and also direct employees to the APC calculator at: https://www.lgpsmember.org/more/apc/index.php

4. To keep a record of the member's pay records for a period of 10 years from the effective date of the certificate.

**Retirement estimates - employer responsibilities:**

1. To submit a request using the Request for Estimate Form by post or attaching it to an encrypted email. Each form must be signed by an authorising officer.

2. To provide pay and other relevant information requested by us either on an individual basis within 10 working days of the request, or for bulk / group requests by an agreed timescale with us.

**Transfer in / out estimates - employer responsibilities:**

1. To submit a request using the Request for Estimate Form by post or attaching it to an encrypted email. Each form must be signed by an authorising officer.

2. To provide pay and other relevant information requested by us either on an individual basis within 10 working days of the request, or for bulk / group requests by an agreed timescale with us.

**Divorce estimates - employer responsibilities:**

1. To provide pay and other relevant information requested by us either on an individual basis within 10 working days of the request, or for bulk / group requests, by an agreed timescale with us.

**Outsourcing estimates - employer responsibilities:**

1. To provide pay and other relevant information requested by us either on an individual basis within 10 working days of the request, or for bulk / group requests, by an agreed timescale with us.

2. Re staff transfers e.g. outsourcings, to ensure early notification / liaison with us when considering an outsourcing exercise which affects members / eligible members of the LGPS.

**Actual retirements - employer responsibilities:**

1. To submit the appropriate Leavers Form to us as soon as the information is available. N.B. The Leavers Form must be completed fully and be signed by an authorising officer, as it confirms the information required to enable the benefits to be calculated and the employer's decision as to the type of benefit that is to be paid to the member.

2. To include a reference in the retirement letter to remind employees to advise us directly if they subsequently move house so that we can maintain contact with the retired member.

**Ill health retirements - employer responsibilities:**

1. To determine whether an ill health benefit award is to be made, based on medical evidence and the criteria set in the LGPS regulations.

2. After obtaining an opinion from an approved Independent Registered Medical Practitioner (IRMP) on the appropriate Medical Certificate, determine which tier (1, 2, or 3) is to be awarded.

3. Submit the completed Medical Certificate and Leavers Form to us with all related paperwork and a copy of the notice letter issued to the member (which must confirm the level of ill health benefits awarded and the appeal information).

4. To keep a record of and at 18 months review all Tier 3 ill health retirements, arranging as appropriate a further medical certificate.

5. To notify us to recover any overpayment of benefits following a discovery of gainful employment.

6. To include a reference in the dismissal letter to remind employees to advise us directly if they subsequently move house so that we can maintain contact with the retired member.

**Members leaving employment before retirement - employer responsibilities:**

1. To notify us using the Leavers Form, ensuring all relevant information is included on the form, within a reasonable time of the members leave date.

2. To include a reference in the acknowledgement letter to remind employees to advise us directly if they subsequently move house so that we can maintain our contact with the retired member.

3. To send us notification of any eligible employees subject to automatic enrolment, who opt out of the LGPS within 6 weeks of joining.

**Deferred members - employer responsibilities:**

1. To keep adequate records of the following for members who leave the LGPS with deferred benefits, as early payment of benefits may be required:

    a. Name.
    b. Last known address.
    c. NI Number.
    d. Payroll number.
    e. Date of birth.
    f. Last job information including job description.
    g. Salary details.
    h. Date and reason for leaving.

2. To determine, following an application from the former employee to have their deferred benefits paid early, whether or not they are eligible for early payment on ill health grounds in line with the criteria set in the relevant (NB these depend on date of leaving) regulations and after seeking suitable medical opinion from an IRMP.

3. To determine whether any actuarial reduction can be waived on compassionate grounds in accordance with the employers Discretionary Policy Statement.

**Death in service - employer responsibilities:**

1 To inform us immediately of an employee who has died – this can initially by telephone or email to enable us to calculate or cease benefits.

2 Any notification of death in service should be followed with the receipt of a completed Leavers Form.

**Death of pensioner / deferred member - employer responsibilities:**

1. Although employers have no responsibilities on the death of these members, it would be helpful if they could help when a dependent contacts them by advising the dependent to contact us.

**Additional voluntary contributions (AVCs), Additional Pension Contributions (APCs) and shared cost APCs (SCAPCs) - employer responsibilities:**

1. To communicate to employees the option of SCAPCs to cover periods of 'lost pensions' and the timeframe they must elect to purchase a SCAPC. **Important note:** Members must elect to make APCs within 30 days of returning to work following the absence, but employers have the discretion to extend this period. This should be laid out in the employer's Policy Statement on discretions.

**Complaints / adjudication of disagreements – employer responsibilities**

1. Under regulation 72 of the LGPS 2013 Regulations, any decisions made by an employer affecting an employee's rights to membership, or entitlement to benefits must be made as soon as is reasonably practicable and notified to the employee in writing including a reference to their right to appeal in line with regulation 73 of the LGPS regulations.

2. An employer must notify us of a decision made under Regulation 72. Every notification must:

   - Specify the rights under Stage 1 and Stage 2 of the appeals procedure quoting the appropriate regulations.

   - Specify the time limits within the appeal, under either stage, which apply.

   - Specify to whom an application for appeal must be made to. For first stage appeals this must be the nominated person of the employer who made the decision. For second stage appeals this will be the appointed person at the Administering Authority.

3. Employers must notify us of any first stage appeals they receive.

4. Each employer is required to nominate and name the person to whom applications under stage 1 of the Appeals Procedure should be made.

## 3. FURTHER INFORMATION

We administer the LGPS and manage over £2,800 million of worldwide assets on behalf of over 200 employers and over 60,000 members.

As at 31 October 2018 we estimate that we were 95% funded.

We have a budget of £800K for pensions administration and 21 staff in our pension administration department. We work with the following:

AEW
Barclays
BNY Mellon
First State Investments
Grant Thornton UK LLP
Hermes Investment Management
Invesco Real Estate
JP Morgan Asset Management
Legal & General Investment Management
LGPS Central Limited
Mercer Human Resource Consulting
MJ Hudson
Nomura Asset Management UK Ltd
Schroder Investment Management
Scottish Widows
Stonepeak Infrastructure partners
UK Green Investment Bank
Venn Partners
Walton Street Capital, LLC

This Pension Administration Strategy has been prepared in accordance with LGPS regulations, see (reg 59): http://www.lgpsregs.org/schemeregs/lgpsregs2013/timeline.php

**Audit**
We are subject to an annual audit of our processes and internal controls. Employers are expected to fully comply with any requests for information from both internal and approved external auditors. Any subsequent recommendations will be considered and where appropriate implemented with employer cooperation.

**Benchmarking**
We will regularly monitor our costs and service performance by benchmarking with other administering authorities. Details of the costs of administration, quality measures and standards of performance will be published in the Annual Report.

**Data Protection Act 2018**
We are a Data Controller as part of the Data Protection Act 2018 which incorporates the General Data Protection Regulation (GDPR). This means we store, hold and manage personal data in line with statutory requirements to enable us to provide pension administration services. To enable us to carry out our statutory duty, we are required to share information with certain bodies, but will only do so in limited circumstances. More information about how we hold data and who we share it with can be found in our Privacy Notice at www.worcestershire.gov.uk/pensions

**Secure Data Transfer**
We will follow Worcestershire County Council's (the Fund's Administering Authority) data security guidelines when sending any personal data, including its published data sharing policy. This means that member's personal data will only be transferred from one party to the other via an acceptable method specified by the Administering Authority which may include any of the following:

- Secure email.
- Paper forms signed by an authorising officer from the employer.
- Password protected Excel spreadsheets.
- Password protected portal.

**FOR OFFICE USE ONLY:**
Worcestershire Pension Fund Pension Administration Strategy
Version: First ever
Author: Chris Frohlich, Engagement Manager
Dated: March 2019
Signed Off: Pensions Committee 19 03 2019

**APPENDIX 1: Employer's contacts at my organisation Excel spreadsheet**

**Organisation**
**In group**
**Companies House**
**email addresses**
**Finance**
**Finance emails**
**Payroll**
**Payroll emails**
**HR**
**HR emails**

worcestershire county council

Pension Fund

# Policy Statement on Communications

## 1 Introduction

We aim to produce clear communications in a plain English style that provide everyone with any interest in the Fund with ready access to all the information they need to make informed decisions.

We may make our communications available in languages other than English or in Braille or in other formats upon request to suit those with special needs.

We can be contacted in person, by letter, by phone or by email.

We aim to respond to all requests in a timely manner and by meeting the enquirer's information objectives.

We will collaborate with other Funds throughout the year to produce communications that benefit from shared expertise and cost saving.

We aim to continually develop our communications / the resource we devote to engagement: our first-ever Engagement Manager joined us on 26 October 2018.

Our flagship communications offering is our website at:
http://www.worcestershire.gov.uk/info/20408/worcestershire_pension_fund

We aim to maintain a compliant website that provides stakeholders with a first port of call for all of their pensions information needs, so that they can make informed decisions. NB we are not able to provide financial advice.

We aim to invest in digitisation to maximise self-service for our members and employers.

## 2 Communicating with employers

We will engage with our prospective and actual employers to:

- Explain our requirements of them.
- Define their information needs and expectations of us.

- Identify and deliver their training needs.

We will maintain an up to date Pension Administration Strategy.

We will maintain an Employers area on our website to provide regularly updated guidance / forms including monthly employer newsletters.

We will deliver a bi-annual employer forum to discuss, manage and communicate major strategic issues, legislation changes and funding matters.

Of the 5 members of our Pension Board there are 2 employer representatives who scrutinise all Pensions Committee decisions and can take items for discussion to our Pensions Committee on behalf of employer.

The Pensions Committee of 8 has 1 employer representative.

## 3 Communicating with members

We will make available a range of publications / forms for prospective and actual scheme members including a Guide to the LGPS.

We will provide an annual benefit statement to our employee members and our deferred members by 31 August.

We will provide an annual newsletter to our employee members and our deferred members.

We will provide an annual newsletter, an annual payslip and a P60 to our pensioner members. We will also provide them with a pension payslip when there is a change of more than £1 per month in their pension.

Of the 5 members of our Pension Board there are 2 member / trade union representatives who scrutinise all Pensions Committee decisions and can take items for discussion to our Pensions Committee on behalf of members.

The Pensions Committee of 8 has 1 member / trade union representative.

## 4 Communications with other stakeholders

Our Annual Report is available from our website.

Our website will also provide up to date information about our governance, funding, investments, finances and operations.

We will deliver appropriate communications to comply with and apply all relevant legislation / guidance (for example from The Pensions Regulator, The Local Government Association, Her Majesty's Revenue & Customs, The Local Government Pension Scheme Advisory Board, etc.).

We will deliver a training programme for members of our Pensions Committee and Pension Board.

**FOR OFFICE USE ONLY:**
Worcestershire Pension Fund Policy Statement on Communications
Version: First ever
Author: Chris Frohlich, Engagement Manager
Dated: Mar 2019
Signed Off: Pensions Committee 19 03 2019

worcestershire countycouncil

**AGENDA ITEM 8**

# PENSIONS COMMITTEE
# 19 MARCH 2018

# ADMINISTERING AUTHORITY UPDATE

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**Recommendation**

1. **The Head of Human Resources and Organisational Development recommends that the Administering Authority update be noted.**

Guaranteed Minimum Pension (GMP) Reconciliation and Rectification

2. Progress continuing by our provider ITM. Activity is reasonably static while they await feedback from HMRC. The table below shows the latest Project Dashboard update.

Project dashboard

| Status | Reconciled | | | | | Proposal | | Unreconciled | | | Other | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | No GMP liability | Exact match | Within tolerance | Accept HMRC | Accept Admin | Proposal to client | Proposal to HMRC | Awaiting data from client* | Awaiting data from HMRC | Further review | N/A record | BAU |
| Active | 12,340 | 449 | 240 | 1,123 | 985 | 39 | 2 | 54 | 886 | 35 | 6,816 | |
| Deferred Post GMP Age | 514 | 90 | 56 | 82 | 74 | | 4 | 11 | 60 | 2 | 189 | |
| Deferred Pre GMP Age | 13,784 | 1,916 | 483 | 1,028 | 1,043 | 62 | 140 | 103 | 807 | 12 | 2,023 | |
| Pensioner Post GMP Age | 3,020 | 4,963 | 2,937 | 722 | 1,008 | 60 | 5 | 203 | 598 | 28 | 498 | |
| Pensioner Pre GMP Age | 521 | 287 | 99 | 504 | 26 | 3 | 1 | 20 | 95 | 15 | 11 | |
| Widow(er) | 88 | 213 | 257 | 27 | 253 | 5 | | 51 | 607 | 103 | 142 | |
| Unlinked dependant | | | | | | | | 135 | - | - | 59 | |
| **Total on admin** | **30,267** | **7,918** | **4,072** | **3,486** | **3,389** | **169** | **152** | **577** | **3,053** | **195** | **9,738** | |
| Other admin | | | | | 1,079 | | 846 | - | 686 | 1 | 25,184 | 6 |
| HMRC only | | | | | 4 | | | 204 | 2,009 | 7 | 8,327 | |
| **Total reported cases – 27 February 2019** | **30,267** | **7,918** | **4,072** | **3,486** | **4,472** | **169** | **998** | **781** | **5,748** | **203** | **43,249** | **6** |
| | | | | | | | | | | | | |
| **Total reported cases - Baseline** | **23,333** | **7,552** | **3,566** | | | | | | **816** | **36,386** | **29,705** | **6** |

*includes cases returned by the Worcester team but not yet processed by ITM. It also includes cases sent to the Worcester team on 5 November relating to the GMP value reconciliation

3. ITM awaiting a large number of responses from HMRC by 1 April 2019.

4. Administering Authority working on queries and returning these to ITM and responses are up-to-date.

5. ITM are preparing Stage 3 rectification proposals which will commence from April.

6. A proposal/decision paper on the Fund's approach to under and overpayments will be presented to the next Committee in June.

Administration Software

7. The Administering Authority currently uses 'Altair' administration software contracted from Aquila Heywood. A project group has been established to review the current contract and in accordance with the procurement arrangements the group plan to re-procure the administration software.

8. The group have identified two issues which need to be actioned. Firstly the current servers will need to be replaced by January 2020 and Aquila Heywood has confirmed that they will cease to support our software version from September 2019. To eliminate these issues and in preparation for a re-procurement exercise, which is estimated will take 18/24 months, it is proposed to extend the current contract and in doing so move the hosting from WCC to Aquila Heywood and for the service to be 'cloud' based.

9. Aquila Heywood has been asked to submit a proposal for this extension and a report will be submitted to the Commercial Board to approve.

10. The project group consists of the Chief Financial Officer, Procurement Manager, ICT Infrastructure & Security Architect, ICT Commercial & Contracts Manager, Pensions Manager, and representatives from the Administering Authority.

Covenant Review

11. The Fund has carried out this analysis to identify and monitor employers which potentially pose a higher risk to the Fund (and the other participating employers, because other employers have to share the deficits of an insolvent employer) with a view to assessing what actions may be needed in order to mitigate the risk and protect the Fund (and other employers). This monitoring forms part of the Fund's wider risk management strategy. Given the Fund has a large number of employers; it would not be practical to assess the covenant in detail for every employer. This analysis is a first step to categorise the employers into broad risk groups and to prioritise action in relation to those employers where there is potentially a higher risk to the Fund so that these employers can be investigated further and/or further data can be gathered to refine the covenant rating.

12. The Fund is using a covenant screening tool developed by Mercer for use in multi-employer schemes and especially LGPS funds. The tool is based on a manageable number of Key Performance Indicators (KPIs). To populate the tool the Employers are asked to provide a small amount of financial data which is combined with the latest estimates of funding levels and deficits to measure aspects of covenant and pension risk. The tool provides risk scores for each employer for each KPI, using a Red/Amber/Green traffic light system. It also provides a summary for the Fund as a whole showing the number of employers in each risk category.

13. Risk scores are then analysed to screen out those employers with lower risk, either because the risk score is low or because other factors mitigate any adverse KPI scores e.g. there is a separate guarantee in place from a tax raising body or Central Government Dept. In this way, the tool identifies a small group of employers for which further work is needed to understand the risk position in more detail. This will include requests for additional data and if appropriate meetings/ discussions to explore any issues arising.

14. For the 40 employers that have been currently categorised overall as red in the analysis but we expect to filter these for the following reasons:

- 21 are categorised as red as we have not received complete data
- 8 have a green rating for KPI test 3. This shows low levels of gearing which would say that they still have the capacity to afford to continue to pay their pension contributions, even though they are running at a cashflow deficit. This will help inform discussions at the valuation
- 4 are larger organisations such as Councils and police and these would generally be considered low risk, but the sustainability of the contribution plan will need very careful consideration.
- The above leaves 7 other red cases for more detailed consideration which shows how the filtering process works using the tool. For these cases, Mercers suggest initial consideration should be given to any guarantee that may be in place e.g. from a letting authority (or the DfE in the case of an academy) as any risk here would lie more with the guarantors than the Fund as a whole. In the absence of such security, consideration can then be given to appropriate funding profiles to address the risk to the Fund. This may well require further discussions with the employers in question and we can link in one of our covenant experts to have a closer look at these specific cases to decide whether we need more information or a pro-active meeting with them.
- Further consideration of the amber and green cases will be undertaken once the red category has been considered.

McCloud Case

15. The following is an extract from the Q&A issued by the Scheme Advisory Board:

**What is the McCloud case?**

The case concerns the transitional protections given to scheme members, who in 2012 were within 10 years of their normal retirement age, in the judges and firefighters schemes as part of public service pensions reform. Tapered protections were provided for those 3-4 years younger. On 20th December 2018 the Court of Appeal found that these protections were unlawful on the grounds of age discrimination and could not be justified.

**What are the potential implications of the case?**

If the protections are unlawful then those members who are found to have been discriminated against will need to be offered appropriate remedies to ensure they are placed in an equivalent position to the protected members. Such remedies will need to be ‘upwards’ - that is the benefits of unprotected members will need to be raised rather than the benefits of protected members being reduced.

**If the case is about the judges and firefighters schemes why could it apply to all public service schemes?**

Protections were applied to all members within 10 years of retirement in all public service schemes, with the form that protection took varying from scheme to scheme. Although the case only relates directly to two schemes it is anticipated that the principles of the outcome could be accepted as applying to all public service schemes.

**Will there be a further appeal?**

The Government has applied to the Supreme Court for permission to appeal. Normally a decision on whether to grant permission is received within 3 months of the application, so by mid-April 2019.

**Why has the cost cap process been paused due to McCloud?**

Should the finding of the Court of Appeal stand then significant changes to public service schemes may be required. Depending on extent and cost of these changes there could be a material impact on the outcome of the cost cap process.

Fair Deal Consultation

16. The Government has issued a consultation document containing proposals to strengthen the pensions protections that apply when an employee of a Local Government Pension Scheme (LGPS) employer is compulsorily transferred to the employment of a service provider.

17. The proposed amendments to the LGPS Regulations 2013 would, in most cases, give transferred staff a continued right to membership of the LGPS. These changes would bring the LGPS in line with the government's October 2013 Fair Deal Guidance that applies in relation to transfers from central government.

18. The closing date for the consultation is 4 April 2019.

## Contact Points

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Bridget A Clark, HR Service Centre Manager
Tel: 01905 766215
Email: bclark@worcestershire.gov.uk

## Background Papers

In the opinion of the proper officer (in this case the Head of Human Resources and Organisational Development) there are no background papers relating to the subject matter of this report.

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**AGENDA ITEM 9**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# WORCESTERSHIRE COUNTY COUNCIL PENSION FUND ADMINISTRATION BUDGET 2019/20

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**Recommendation**

**1. The Chief Financial Officer recommends that:**

**a) The variation to the Pension Fund Administration Budget, including manager fees, for 2018/19 shown in the Appendix totalling £11.213m be agreed;**

**b) The Pension Fund Administration Budget, including manager fees, for 2019/20 shown in the Appendix totalling £12.640m be approved;**

**c) The indicative budget allocations for 2020/21 and 2021/22 be noted;**

**d) Variations against budget will be monitored be noted; and**

**e) He be granted delegated authority to approve variations of up to £0.5m.**

**Purpose of the report**

2. This report seeks Members' approval for the 2019/20 for the Worcestershire County Council Pension Fund Administration Budget, as shown in the attached Appendix. The budget and Forecast Outturn for 2018/19 are also shown.

3. The Appendix also shows indicative budgets for the following two years 2020/21 and 2021/22. These budgets are indicative and incorporate the actions to meet the next Triennial valuation, the Investment Strategy and improved communication and engagement.

**Background**

4. To ensure good governance budgets are required to monitor the stewardship of the Fund's expenditure and financial plans assist in mitigating risks by allocating necessary resources to develop the service.

5. A number of services are required to ensure delivery of the Local Government Pension Scheme (LGPS) administering authority function. The Committee has ultimate responsibility for the procurement and monitoring of these services. It should be noted, however, that Worcestershire County Council, which is one of the employer bodies whose interests the Committee is responsible for, is at present also the provider of a number of these services.

## Forecast outturn 2018/19

6. The attached Appendix shows the forecast outturn estimated to be £11.213m compared to a budget of £9.931m, a difference of £1.282m. The key reason for the variance is investment management fees - when the original budget was set it was assumed that the management fees relating to our investment of £100m in the US Property Fund 'Stonepeak' would be incurred as the capital was gradually invested over the next 2 to 3 years. However the management fees are based on the committed sum rather than as the capital is invested, hence the significant variance.

7. Given this variation is more than the £0.5m delegated to the Chief Financial Officer Committee is asked to approve this variation.

8. There has been an Increase in pensions investment administration due mainly to additional consultancy advice and support of the Pensions Investment Finance manager, this is offset by some savings on running costs within pensions admin

## Key features of the proposed 2019/20 budget

9. The budget now proposed for 2019/20 is £12.640m, an increase of £2.709m (+27%) from the original 2018/19 budget (see Appendix). The largest proportion of the budget (£10.599m) is investment managers' fees that largely depend on the value of assets being managed, and the investment return performance which depends on market conditions. This includes the management fees for the Equity Protection that has been implemented and the contribution towards LGPS central.

10. The key reason for the increase in budget is the management fees are as follows:-

a) Increase in assumed investment returns;
b) The strategy to increase our asset allocation to 15% of the portfolio into Property and Infrastructure and reduce our equity portfolio to 75% (from 80%) will increase our management fees given the low fees on our passive equity portfolio; and
c) Our investment of £100m in the US Property Fund 'Stonepeak and £65m in the Corporate Private Debt fund with EQT are based on the committed sum rather than as the capital is invested which was included in the original budget.

11. The Fund's "controllable" budget (i.e. excluding investment management fees) is £2.040m, which is a £0.052m (0.5%) net increase. The key reasons for this increase are:

***Areas of increase in budget***

a) Full year effect of an appointment of a Communications and Engagement Officer from October 2018 at a cost of £43k per annum;

b) New developments in the Pensions administration systems provided by Altair including hosting the self service for members. £116k to system costs (includes £40 set up costs) was added in 2019/20;

c) Similar to how the county council provides for elections that occur over a longer period, we have provided an additional provision of £80k for 2019/20 for the cost of the triennial actuarial valuation of the fund as at April 2019; and

***Areas of decrease in budget***

d) The Guaranteed Minimum Pension Exercise which was approved by Committee on the 22 June 2018 was included as a one off exercise in 2018/19 totalling £191k and therefore not required in 2019/20.

***Summary***

12. The budget attempts to maintain service standards, fulfil statutory requirements while developing areas in response to the scheme changes. Comparability of data is difficult between funds nationally due to different methodology of reporting costs.

13. The budgeted Worcestershire Pension Fund administration costs are currently £23.69 per member for 2018/19. The proposed budget will take these costs to £23.25 per member (0.05% of the market value of the Fund's assets).

14. In terms of investment costs, the budget indicates spend of 42p per £1,000 (0.42% of market value as at December 2018) on managing its assets for 2019/20, including all pooled mandate costs

**Risk Assessment**

15. The Committee is asked to recognise that some costs, particularly investment fees, are dependent upon factors that are outside of the Council's control. As such fees may go up or down, depending on market conditions.

16. The approval of this budget is essential to continue the good governance of the Fund. When viewed in relation to the overall value of assets, these 'controllable' costs represent 0.08% of the total Fund value.

17. In line with good governance practice, officers are bringing budget monitoring reports back to Committee twice a year. In the interim, variations against budget will be monitored and if they become very significant, the Chief Financial Officer to the Pension Fund will approve variations to the budget and report these to the Committee retrospectively for ratification.

**Contact Points**

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Rob Wilson
Pensions Investment, Treasury Management & Capital strategy manager
Tel: 01905 846908
Email: RWilson2@worcestershire.gov.uk

**Supporting Information**

- Appendix detailing the proposed 2018/19 Administration Budget monitoring and 2019/20 Administration Budget with indicative budget allocations for 2020/21 and 2021/22

**Background Papers**
In the opinion of the proper officer (in this case the Chief Finance Officer) there are no background papers relating to the subject matter of this report.

## Pension Fund Administration Budget Monitoring 2018/19, proposed budget 2019/20 and indicative budgets 2020/21 & 2021/22

| 2018/19 *Budget* £ | 2018/19 *Forecast Outturn* £ | 2018/19 *Variance* | *Description* £ | 2019/20 *Annual Change* £ | 2020/21 *Annual Change* £ | 2021/22 *Annual Change* £ | Comments |
|---|---|---|---|---|---|---|---|
| | | | **Fund Investment** | | | | |
| **7,942,600** | **9,224,700** | **1,282,100** | INVESTMENT MANAGEMENT FEES | **10,599,400** | **11,041,500** | **11,496,200** | *Includes LGPS central Fees, Equity Protection and increasing commitment to Property & Infrastructure* |
| 128,900 | 173,700 | 44,800 | Investment Administration Recharge | 177,200 | 180,700 | 184,300 | *Increased Investment support* |
| 360,000 | 360,000 | 0 | Investment Custodial and related services | 367,200 | 374,500 | 382,000 | |
| 55,100 | 82,500 | 27,400 | Investment Professional fees | 77,900 | 68,300 | 68,700 | *Increased support over next 2 years to Manager* |
| 14,600 | 15,000 | 400 | Performance Measurement | 15,300 | 15,600 | 15,900 | *CEM Benchmarking* |
| **558,600** | **631,200** | **72,600** | INVESTMENT ADMINISTRATION COSTS | **637,600** | **639,100** | **650,900** | |
| | | | **Scheme Administration** | | | | |
| 1,157,900 | 1,069,672 | -88,228 | Pension scheme Administration recharge | 1,031,000 | 1,015,700 | 1,039,800 | *GMP one off exercise in 18.19, New Altair developments including self service and other website development, changes to team structure.* |
| 200,000 | 215,100 | 15,100 | Actuarial services | 300,000 | 240,000 | 240,000 | *Triennial valuation allowed for April 2019* |
| 27,500 | 27,500 | 0 | Audit | 27,500 | 27,500 | 27,500 | |
| 33,500 | 33,500 | 0 | Legal Fees | 33,500 | 33,500 | 33,500 | |
| 11,200 | 11,200 | 0 | Committee and Governance recharge | 11,000 | 11,000 | 11,000 | |
| **1,430,100** | **1,356,972** | **-73,128** | SCHEME ADMINISTRATION COSTS | **1,403,000** | **1,327,700** | **1,351,800** | |
| **1,988,700** | **1,988,172** | **-528** | GRAND TOTAL (Excluding Investment Mgt Fees) | **2,040,600** | **1,966,800** | **2,002,700** | |
| **9,931,300** | **11,212,872** | **1,281,572** | GRAND TOTAL (Including Investment Mgt Fees) | **12,640,000** | **13,008,300** | **13,498,900** | |

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**AGENDA ITEM 10**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# PENSION FUND TRAINING PROGRAMME FOR PENSIONS COMMITTEE MEMBERS AND PENSION BOARD

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## Recommendation

1. **The Chief Financial Officer recommends that:**

   a) **The feedback from the Pensions Training event on the 18 December 2018 attached as Appendix 1 be noted; and**

   b) **The Training plan be noted and any further topics be identified for future training events;**

## Reason for Recommendations

2. To ensure that an appropriate approach to training is in place that ensures strong governance of the Fund.

## Purpose of Report

3. This report addresses the training requirements of the Pensions Committee.

## Background

4. A report was presented to Committee on the 5 June 2018 on Training for Pension Committee Members that provided details on:

   a) The adopted Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Public Sector Pensions Finance Knowledge and Skills and the CIPFA Knowledge and Skills Framework for Elected Representatives and Non Executives in the Public Sector as the basis of its Training Policy and Programme;
   b) Training Policy;
   c) CIPFA Framework;
   d) Fund documents and training materials;
   e) Pensions regulator training toolkit; and
   f) Training programme for 2018/19.

5. Following on from this, a proposed training programme was developed for Pensions Committee and Board Members up to March 2020 and is attached at Appendix 2.

6. The timescales for delivery of the training is proposed to be around the same time as the Committee and the suggested topics have been split between a mix of Pensions Administration and Investment areas

7. Members are asked to comment on the suggested training programme, suggest any other topics for future training and if agreed steps will be taken to formalise the training events.

8. A training event was provided to members of the Committee and the Pension Board on the 18 December and the formal feedback from this event is detailed in Appendix 1. On the whole the event was well received but only 8 out of a possible 15 members attended.

## Contact Points

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Rob Wilson
Pensions Investment, Treasury Management & Capital strategy manager
Tel: 01905 846908
Email: RWilson2@worcestershire.gov.uk

## Supporting Information

- Appendix 1 – Training event feedback
- Appendix 2 - Training Programme

## Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the background papers relating to the subject matter of this report are detailed in the 'Training for Pensions Committee Members report to Pension Committee on the 22 June 2018

# Training Evaluation Form

**Title of event: Pensions Admin & Investment Training**

**Date of event: 18th December 2018**

**Location of event: Lakeview Room, County Hall, Worcestershire**

**Trainers:**

| **Instructions:** Please tick your level of agreement with the statements listed below | Strongly Agree | Agree | Disagree | Strongly Disagree | Not relevant to this event |
|---|---|---|---|---|---|
| 1. The objectives of the training were met | 1 | 7 | | | |
| 2. The presenters were engaging | 2 | 6 | | | |
| 3. The presentation materials were relevant | 1 | 7 | | | |
| 4. The content of the course was organised and easy to follow | 3 | 5 | | | |
| 5. The trainers were well prepared and able to answer any questions | 6 | 2 | | | |
| 6. The course length was appropriate | 4 | 4 | | | |
| 7. The pace of the course was appropriate to the content and attendees | 3 | 5 | | | |
| 8. The exercises/role play were helpful and relevant | N/A | N/A | N/A | N/A | N/A |
| 9. The venue was appropriate for the event | 1 | 5 | 1 | 1 | |

10. What was most useful?

- Equities
- Admin stuff
- Admin useful
- The transition process
- Equities session as this was new but I enjoyed all the sessions
- Pension lifecycle part 1

11. What was least useful?

- All Helpful
- Transitioning was very interesting but less useful
- Transitional information
- Colin was a little difficult to follow but did clarify the points following questions
- It was all useful thankyou
- None of it

12. What else would you like to see included in this event? Are there any other topics that you would like to be offered training courses in?

- Very helpful to my role
- Suggestions put forward by Bridget for future Admin areas looks good
- As produced
- More detail on bonds and covenants
- As per suggestions by Bridget

13. Would you recommend this course to colleagues? Yes/No Why?

- Yes clear, well timed with good presenters
- Certainly the pensions lifecycle part 1 as extremely relevant and important for managers and employees to be able to identify with roles and responsibility within and employee/ employer relationship.

14. Any other comments?

- Some concern at moving to a 4 yearly revaluation

**Appendix 1**

## Worcestershire County Council Pension Fund
## Proposed Training Programme for Pension committee & Board Members

| | Training Topics | 18/09/2018 | 18/12/2018 | 17/04/2019 | 19/06/2019 | 16/10/2019 | Jan 2020 to be confirmed | Apr 2020 to be confirmed |
|---|---|---|---|---|---|---|---|---|
| | **Investments** | | | | | | | |
| 1 | Investment pooling – An update on progress | Y | | | | | | |
| 2 | Joint working – An update on progress | Y | | | | | | |
| 3 | An overview of the main asset classes e.g. equities, bonds, private equity, trade finance, global property, infrastructure | Y | | | | | | |
| 4 | Transitioning of Assets to the LGPS Pool | | Y | | | | | |
| 5 | Equities (including sustainable equities) | | Y | | | | | |
| 6 | Fixed Income (Private Debt, Bonds etc.) | | | Y | | | | |
| 7 | Alternatives (Property & Infrastructure) | | | | Y | | | |
| 8 | Sustainable Investing | | | | | | Y | |
| 9 | Alternative Indexation | | | | | | | Y |
| 10 | China; a new horizon | | | | | | Y | |
| 11 | Financial Markets | | | | Y | | | |
| 12 | De risking of the Investment Strategy | | | | Y | | | |
| 13 | Responsible Investment | | | | | Y | | |
| 14 | The Investment Regulations | | | | | Y | | |
| 15 | Performance and risk management of a pension fund (PEL & CEM Benchmarking) | | | Y | | | | |
| | **Administration and Governance** | | | | | | | |
| 16 | Guaranteed Minimum Pension (GMP) | Y | | | | | | |
| 17 | The role of the Pensions Regulator | | | Y | | | | |
| 18 | Administrative Authority Lifecycle overview | Y | | | | | | |
| 19 | Covenant Monitoring | Y | | | | | | |
| 20 | General Data Protection Regulations (GDPR) | | | | | | Y | |
| 21 | Actuarial valuations and Triennial Review | | | | Y | | | |
| 22 | Administrative processes and Lifecycle (Part one and Two) See below for topics | | Y | Y | | | | |
| 23 | Additional Voluntary Contributions | | | | | | Y | |
| 24 | Demonstration of the proposed website developments and online functionality for scheme members | | | | Y | | | |
| 25 | knowledge of the duties and responsibilities of committee members | | | | | Y | | |
| 26 | Data quality | | Y | | | | | |
| 27 | Role of the Trustee | | | | Y | | | |
| 28 | Pension accounting and audit requirements | | | | Y | | | |
| 29 | Corporate Governance and shareholder activism, including the Myners Principles | | | | | Y | | |
| | | | | | | | | |

| **Administration Lifecycle** | Part One 18/12/2018 | Part Two 17/04/2019 |
|---|---|---|
| • **Employers** | Y | |
| • **Membership** | Y | |
| • **Leavers** | Y | |
| . **Transfers in and Out** | Y | |
| **Additional Voluntary Contributions (AVC)'s** | | Y |
| **Nominations** | | Y |
| **Divorce** | | Y |
| **Decisions and Appeals (IDRP) & The Pensions Ombudsman** | | Y |

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**AGENDA ITEM 11**

# PENSIONS COMMITTEE
# 19 MARCH 2018

# RISK REGISTER

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**Recommendation**

1. **The Head of Human Resources and Organisational Development recommends that the re-formatted and updated Risk Register be noted.**

2. The risk register (see attached Appendix) has been through a major refresh including a review of all previous risks, a new format and has been updated.

3. The fund risk register includes investment, governance and administration risk.

4. This new risk register replaces the risk register considered by the Pensions Committee on 28 November 2018.

5. This new Risk Register introduces a new approach to measuring risk. The following colour coding is used for the residual risk scores:

   a) Red > = 45
   b) Amber >= 25 but < 45
   c) Green < 25

6. Risk scores can range from 0 to 100 and are derived by multiplying an impact score by a probability score as follows:

**Impact** = 0 (none); 5 (minor); 15 (moderate); 20 (major); or 25 (severe).
**Probability** = 0 (no chance); 1 (25% likely to happen); 2 (50:50); 3 (75% likely); or 4 (certain to happen).

7. The risk register shows the following number of risks by colour category:

   a) Red – 5 risks
   b) Amber – 11 risks
   c) Green - 13 risks

8. The risk register will be kept under regular review and will be reported to each Committee. Future reports will identify risks which have changed score/category for improved tracking/monitoring purpose.

**Contact Points**

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Bridget A Clark, HR Service Centre Manager
Tel: 01905 766215
Email: bclark@worcestershire.gov.uk

## Supporting Information

- Appendix – Risk Register

## Background Papers

In the opinion of the proper officer (in this case the Head of Human Resources and Organisational Development) there are no background papers relating to the subject matter of this report.

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# Pension Fund

# Risk Register

As at 27 02 2019

**About this Risk Register**

It replaces the Risk Register considered by the Pensions Committee on 28 November 2018.

It is a major refresh of that Risk Register and introduces a new approach to measuring risk.

The following colour coding is used for the residual risk scores:

- Red > = 45 (07 risks)
- Amber >= 25 but < 45 (10 risks)
- Green < 25 (12 risks)

Risk scores can range from 0 to 100 and are derived by multiplying an impact score by a probability score as follows:

**Impact** = 0 (none); 5 (minor); 15 (moderate); 20 (major); or 25 (severe).

**Probability** = 0 (no chance); 1 (25% likely to happen); 2 (50:50); 3 (75% likely); or 4 (certain to happen).

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 10 (Chief Financial Officer) | Being reliant on LGPS Central Limited delivering its forecasted cost savings. | Paying too much in fees / investment underperformance. | 25 | 3 | 75 | The Pension Investment Advisory Panel monitors the costs of being a partner fund of LGPS Central Limited. LGPS Central's Practitioners' Advisory Forum works on changes to mitigate this risk. The Pensions Committee and Fund officers carry out a subjective review and objective analysis of these costs following advice from its investment adviser. The Pensions Committee met with officers of LGPS Central at its meeting of 28 Nov 2018 to raise its concerns. | 25 | 3 | 75 RED |
| WPF 06 (Chief Financial Officer) | Fair Deal consultation proposals being implemented. | Increasing administrative complexity. | 25 | 3 | 75 | When the regulations come out the Fund will develop measures to mitigate this risk. Risk profile analysis is performed to understand the strength of an employer's covenant when setting the terms of admission agreements (that may require bonds), and the Fund will ensure that employers are made aware of consequences of their decisions and that they are financially responsible. | 25 | 2 | 50 RED |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 12 (Chief Financial Officer) | Mismatch in asset returns and liability movements. | Exposure to risk or missing investment opportunities or increases in employer contributions. | 25 | 3 | 75 | The Fund regularly reviews its Investment Strategy Statement, has a diversified portfolio and implements a policy of extended recovery periods to smooth employer contributions. Qualified advisers including an independent investment adviser are contracted, and the funding position / mortality and morbidity experience is reviewed regularly by the Pensions Committee. Equity Protection has been implemented to protect assets up to the 2019 actuarial valuation (valuations are conducted every 3 years). Fund officers meet with investment managers on watch more frequently than with other managers. New ideas are always encouraged by officers who also carry out peer group discussions. | 25 | 2 | 50 RED |
| WPF 19 (HR Service Centre Manager) | Failure to procure a pensions admin system for the future. | Inability to pay pensions / reputational or financial loss / staff downtime / loss of service delivery / data loss. | 25 | 3 | 75 | Project team is established. The appropriate specialists are supporting the procurement. The Fund recognises that there is a small market of suppliers and may be able to collaborate with other LGPS Funds if our timescales allow. Following receipt of a proposal from the existing supplier, a Procurement Exemption Form will be tabled before the mid-March Commercial Board to agree. | 25 | 2 | 50 RED |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 24 (HR Service Centre Manager) | Employers having insufficient skilled resources to supply our data requirements. | Missing, incomplete and incorrect records on pensions administration system that undermines service delivery and causes difficulties in establishing correct benefits at individual level / liabilities at employer and whole of Fund level. Potential issues with The Pensions Regulator. | 15 | 3 | 45 | The Fund will remind employers about their responsibilities when it launches the Pension Administration Strategy (that advises employers that the Fund will pass on any fines and has the right to charge interest for late payments) wef 1 April 2019 and supports employers with monthly newsletters / its website / employer fora. Checking individual records at points of significant transaction and periodic bulk data checking by the actuary. | 15 | 3 | 45 RED |
| WPF 11 (Chief Financial Officer) | Failure to pool assets using LGPS Central Limited. | Lack of compliance with Ministry of Housing Communities & Local Government (MHCLG) requirements. | 25 | 3 | 75 | The Fund is a working member and shareholder of the LGPS Central pool. The pool went live from the 1st April 2018 and met the government's pooling timetable and to the required standard. It also complied with FCA regulations. Each pool member has an equal share in the pool and the first Shareholders meeting and central committee have taken place. There is a Practitioners Advisory Form (PAF) with the pool's investment managers that meets monthly. The pool has a number of work streams: investments; client reporting; finance; responsible investment; and governance. Formal transition procedures are in place. The fund will take legal advice before not pooling its assets. | 20 | 2 | 40 AMBER |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 23 (Chief Financial Officer) | Employers cannot pay their contributions. | Increase in liabilities. | 20 | 3 | 60 | Risk profile analysis is performed to understand the strength of an employer's covenant when setting the terms of admission agreements (that may require bonds) and in setting the term of deficit recovery periods during the actuarial valuation process, whilst attempting to keep employer contributions as stable and affordable as possible. The Fund pursues a policy of positive engagement with a view to strengthening employer covenants wherever possible. Contribution increases are phased over a three year period for most employers and allowances are provided for short term pay restraint where evidence is provided. The Fund monitors membership profiles and changes and ensures that employers are reminded of their responsibilities through sending reminders of employers responsibilities where this is appropriate. The Fund is developing a closer focus on covenants, employer grouped investment strategies and working with at risk employers. | 20 | 2 | 40 AMBER |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 08 (Chief Financial Officer) | Failure to appoint suitable investment managers and review their performance / markets / contracts. | Investment underperformance / regulatory non-compliance / paying too much in fees. | 25 | 3 | 75 | The Pension Investment Advisory Panel monitors performance of the Fund's diverse range of investment managers, meeting with / placing managers on watch as appropriate. The Pensions Committee and Fund officers carry out a subjective review and objective analysis of asset performance resulting from decisions taken by the Pensions Committee following advice from the investment adviser, LGPS Central Limited / its partner Funds, and the Pension Investment Advisory Panel. Contract service is reviewed quarterly by the Pension Investment Advisory Panel and approved by Pensions Committee. The Finance Manager - Pensions reviews investment managers' internal control reports and reports any significant exceptions to the Chief Financial Officer. | 25 | 1 | 25 AMBER |
| WPF 01 (Chief Financial Officer) | Failure of governance arrangements to match up to recommended best practice. | Financial loss or loss of reputation / employer confidence or need to make major changes at short notice. | 25 | 2 | 50 | The Fund produces an annual Governance Compliance Statement for inclusion in its annual report. That report is signed off by its auditors. | 25 | 1 | 25 AMBER |
| WPF 03 (Chief Financial Officer) | Failure of officers to maintain sufficient level of knowledge / competence. | Inability to carry out their duties. | 25 | 3 | 75 | Officers are appropriately qualified and participate in various scheme / industry groups / fora to keep up-to-date on pensions issues. They also review specialist publications. The Fund plans to develop its own workforce strategy. | 25 | 1 | 25 AMBER |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 07 (Chief Financial Officer) | Future change to LGPS regulations or other legislation, for example the LGPS cost cap. | Increasing administrative complexity or failure to comply with The Pensions Regulator. | 25 | 3 | 75 | Officers participate in various scheme and industry groups and fora. The Committee and Board monitor LGPS developments. Roger Phillips is on the LGPS Scheme Advisory Board. | 25 | 1 | 25 AMBER |
| WPF 17 (Chief Financial Officer) | Failure of custodian to deliver the services contracted. | Loss / inaccessibility of assets / inability to invest. | 25 | 1 | 25 | The Finance Manager - Pensions reviews managers' SAS70 audit reports. The Fund has diversification of custody via pooled funds. Contract service is reviewed annually and there are regular meetings with the supplier, BNY Mellon. | 25 | 1 | 25 AMBER |
| WPF 18 (Chief Financial Officer) | Failure of existing pension admin system to deliver the services contracted. | Inability to pay pensions / reputational or financial loss / staff downtime / loss of service delivery / data loss. | 25 | 2 | 50 | Contract service is reviewed annually and there are regular meetings with the supplier, Aquila Heywood. Robust system maintenance routines. Internal and external systems support. Back-up procedures. Business Continuity Plan. The Pension Administartion Strategy reminds employers of their responsibility to provide accurate and timely information on pay. | 25 | 1 | 25 AMBER |
| WPF 20 (Chief Financial Officer and HR Service Centre Manager) | Staff leaving or going on long term absence. | Insufficient staff resource or remaining staff not having the skills to do their areas of work. | 25 | 2 | 50 | Cross skilling is achieved by mentoring to develop officers with a high level of knowledge and experience. Functions are reviewed to ensure they are sufficiently staffed / have succession planning. Specialist agency cover is available. Absences will be managed in line with Worcestershire County Council's new attendance policy. | 25 | 1 | 25 AMBER |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 21 (Chief Financial Officer) | Failure of business continuity planning, for example hosting of pensions administration software on Worcestershire County Council's (WCC) servers. | Inability to deliver critical functions like paying pensioners. | 25 | 2 | 50 | The Fund and the Council have Business Continuity Plans in place and these are regularly tested. The Fund will ensure that WCC includes delivery of support services to the Fund in its risk register. Remote access is widely in use by officers. | 25 | 1 | 25 AMBER |
| WPF 28 (HR Service Centre Manager) | Cyber attack leading to loss of personal data like bank account details. | Data Protection breach / fraud. | 25 | 2 | 50 | The Fund conforms with (Worcestershire County Council) WCC's breach notification process and WCC's data policy, for example through the use of data encryption and password protection. Systems currently (this will be changing) hosted by WCC are reviewed by internal and external audit and set up in line with data protection regulations. A complete address update is done regularly by employers. Mitigating processes include the Business Continuity Plan (BCP), data breach, addresses being checked by a dedicated checker and communication taking place with member / employer before a payment is made. All post office returns are investigated and followed up and nothing is sent out if new address is not found. | 25 | 1 | 25 AMBER |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 04 (Chief Financial Officer) | Not having established and meaningful Operational Plans, Pension Administration Strategy, complaint monitoring and key performance indicators (KPIs). | Poor decision making and delays in responding to stakeholders e.g. elected members. | 5 | 4 | 20 | A KPI report is maintained and updated by the Finance Manager and is reviewed by the Pension Board and Pensions Committee on a regular basis. Investment performance is independently confirmed by Statesmen. E5 (our accounting system) management reports are available and automatic reporting is in place on the pensions admin system. A Pension Administration Strategy will be in place on 1 April 2019. Operational Plans will be tabled at the March Pensions Committee. | 5 | 4 | 20 GREEN |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 22 (Chief Financial Officer) | The number of early retirements increases to levels in excess of the actuarial assumptions adopted. Pay and consumer price inflation significantly different from actuarial assumptions. | Increases required in employers contributions. | 20 | 2 | 40 | Employers are required to pay lump sums to fund costs for non-ill health cases. The Actuary monitors early retirement (including on the grounds of ill-health) experience being exhibited by the Fund's members and consequently adjusts the actuarial assumptions. The Fund ensures that employers are made aware of consequences of their decisions and that they are financially responsible. At each triennial actuarial valuation an analysis is carried to ensure that the assumptions adopted are appropriate. The Fund holds discussions with employers through the Pension Administration Advisory Forum over the expected progression of pay in the short and long term. This information is then fed back to the Fund's Actuary with medium term financial plan budget evidence provided, if required. The Government's plan to increase pensions by the Consumer Prices Index Housing (CPIH) instead of CPI in future will reduce the Fund's liabilities. | 20 | 1 | 20 GREEN |
| WPF 02 (Chief Financial Officer) | Insufficient knowledge amongst members of Pensions Committee / Pension Board / Pension Investment Advisory Panel members. | Poor decision making / scrutiny. | 15 | 2 | 30 | Training policy, sessions and plans have been implemented in line with the Chartered Institute of Pension Fund Accountants (CIPFA) knowledge and skills framework / best practice guidance to include induction training sessions for new members and quarterly ongoing training for all members. | 15 | 1 | 15 GREEN |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 05 (Chief Financial Officer) | Failure to disclose relevant facts in the Annual Report or during audit(s). | Audit criticism or reputational damage. | 15 | 2 | 30 | Robust review and sign off processes are in place to check the disclosure of relevant facts. Accounts are reviewed prior to sending them to external audit. The accounts are also checked against the Chartered Institute of Pension Fund Accountants (CIPFA) example accounts and external audit accounts checklist. | 15 | 1 | 15 GREEN |
| WPF 13 (Chief Financial Officer) | Liquidity / cash flow is not managed correctly. | Assets may need to be sold at unplanned times or investment opportunities may be missed. | 15 | 2 | 30 | Finance Manager - Pensions monitors Fund cash flow on a monthly basis. The Fund currently has under 10% of total net assets exposure to illiquid assets. All contributing employers are provided with deadlines for payments and clear guidelines for providing associated information. The Fund monitors contributions payable and paid on a monthly basis and also reconciles to E5 (our accounting system) on a monthly basis. | 15 | 1 | 15 GREEN |
| WPF 14 (Chief Financial Officer) | Failure to exercise proper stewardship of the Fund's assets. | Potential erosion of investment returns or reputational damage. | 15 | 2 | 30 | The Fund has a Statement of Compliance with the Stewardship Code that will be reviewed regularly and participates in the Local Authority Pension Fund Forum (LAPFF) and other groups. The Pension Investment Advisory Panel monitors Environmental, Social and Governance (ESG) policy regularly. | 15 | 1 | 15 GREEN |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 26 (HR Service Centre Manager) | Fraud by staff. | Financial loss. | 15 | 1 | 15 | Changes to Altair leave a footprint that identifies who made the change. Manager checking is in place. Citrix has log-in security and Altair has multiple login protections. Month end reconciliations are also carried out. Declarations by staff of personal relationships / family members is required. Internal Audit review the Fund's processes regularly. | 15 | 1 | 15 GREEN |
| WPF 15 (Chief Financial Officer) | Failure of the actuary to deliver the services contracted. | Financial loss or loss of reputation / employer confidence or need to make major changes at short notice. | 20 | 1 | 20 | Contract monitoring is in place and was reviewed in 2017. There are regular meetings with the supplier, Mercer. | 5 | 1 | 5 GREEN |
| WPF 16 (Chief Financial Officer) | Failure of investment adviser to deliver the services contracted. | Financial loss or loss of reputation / employer confidence or need to make major changes at short notice. | 20 | 1 | 20 | Contract service is reviewed annually and there are regular meetings with the supplier, M J Hudson. | 5 | 1 | 5 GREEN |
| WPF 25 (HR Service Centre Manager) | Fraud by scheme members. | Financial loss. | 5 | 1 | 5 | The Fund carries out National Fraud Initiative (NFI) checks, sends payroll slips / communications at intervals through the year to home addresses and requires evidence of certificates (e.g. birth certificate). | 5 | 1 | 5 GREEN |
| WPF 27 (HR Service Centre Manager) | Incorrect calculation of benefits through human error or delayed notification of a death. | Too much being paid out in benefits. | 5 | 1 | 5 | In addition to system testing the Fund has a test system and a test site for Altair (the pension payroll system). Every calculation has independent checking and set procedures. Staff receive training and performance is benchmarked. The Fund has an overpayments process and reports overpayments to the Pensions Committee. Tracing agencies are used for members aged 65+. Life Certificates are also used. | 5 | 1 | 5 GREEN |

| WPF Risk Register as at 27 Feb 2019 Risk Reference (owned by) | Description of Risk | Leading to | Gross Impact | Gross Probability | Gross Risk Score | Mitigating Action | Residual Impact | Residual Probability | Residual Risk Score |
|---|---|---|---|---|---|---|---|---|---|
| WPF 29 | Failure to deliver member communications in line with regulatory requirements, for example the 31 August annual benefit statement deadline. | Financial loss or loss of reputation / employer confidence or need for corrective action at short notice. | 5 | 1 | 5 | The Fund has a Policy Statement on Communications. Employee annual benefit statements that are returned to the Fund are passed on to the member's employer. Tracing agencies are used for finding deferred members aged 55+. | 5 | 1 | 5 GREEN |
| WPF 09 (Chief Financial Officer) | Being reliant on LGPS Central Limited's investment approach following transitioning of assets. | Investment underperformance / regulatory non-compliance. | 25 | 3 | 75 | No assets will be transferred until May 2019. The Pension Investment Advisory Panel monitors performance of this investment manager. The Pensions Committee and Fund officers carry out a subjective review and objective analysis of asset performance resulting from decisions taken by the Pensions Committee following advice from its investment adviser. The Pensions Committee met with officers of LGPS Central Limited at its meeting of 28 Nov 2018 to raise its concerns. | 25 | 0 | 0 GREEN |

worcestershire countycouncil

**AGENDA ITEM 12**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# 2019 – 2022 BUSINESS PLAN

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**Recommendation**

1. **The Chief Finance Officer recommends that the Pension Committee note the report and that a further update is brought to the June Committee.**

**Introduction**

2. The purpose of the Worcestershire Pension Fund (WPF) Business Plan 2018 - 2020 is to outline the Fund's strategic direction, goals and objectives, as well as providing Action Plans (project and business as usual) of the key priorities in order to further these objectives and setting a sustainable financial plan.

3. The Local Government Pension Scheme (LGPS) has been and remains in a period of uncertainty over further potential nationally imposed changes. A new Career Average Revalued Earnings (CARE) scheme was introduced from 1 April 2014, but concerns remain over the long-term cost and sustainability of the LGPS while the Government remain focussed on addressing pension fund deficits and reducing the costs of running the scheme.

4. The Fund continues to face increasing complexities in both the governance and administration of the scheme increasing pressure on resources and workloads. These include, but not an exhaustive list, the jurisdiction of the Pension Regulator and changes to the requirements for record keeping, data cleansing and covenant reviews, responsibility to the national Scheme Advisory Board, changes to the tax relief allowances, provision of data to/from HMRC for the guaranteed minimum pension reconciliation and rectification, increasing numbers of employer organisations (from outsourcing and academy conversions), delivery and monitoring of a robust investment strategy to create stability in employer contribution rates, and increasing expectations from stakeholders (e.g. scheme member and employer access to information). This means that the Fund will need to be flexible and responsive enough to adapt to all these changes.

**Purpose and Vision of the Fund**

5. The WPF is one of 91[1] funds administering the LGPS nationally. Worcestershire County Council is the statutorily appointed Administering Authority for the WPF. The LGPS is funded principally by its constituent employers and members, with assistance from investment returns. Unlike other public sector pension schemes, the LGPS is fully invested in financial markets / instruments and aimed to be fully funded over the long-term.

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[1] Extracted from Scheme Advisory Board website 2019

6. The WPF acts as the "custodian" of the scheme for future generations with the aim to ensure it's in the best shape as possible in managing its assets (investments) and liabilities (pensioners).

7. The WPF recognise the importance of the LGPS to its Scheme Members as an excellent scheme, providing significant benefits to members and its contribution to the wider economy by potentially keeping people out of means tested support in their retirement. It is also a valuable recruitment tool for employers which assists in attracting and retaining staff but with the appreciation of the significant liabilities it can generate for them.

8. The long-term goals[2] of the Fund are thus:

- To achieve and maintain a 100% solvency level over a reasonable period of time and then maintain sufficient assets in order for it to pay all benefits arising as they fall due.
- Maintain a managed risk investment and funding strategy to achieve the first goal.
- Maintain stabilised employer contribution rates.
- To provide a high quality, low cost customer focused service.
- To be open and honest in all our decision making.

9. The WPF intends to achieve its vision and goals by focussing on the following five key areas:

**Governance & Staffing**

10. To ensure the ***effective management and governance of the Fund*** in a way that strives for continuous improvement through improved value for money, the promotion of excellent customer service and compliance with all regulatory and best practice requirements.

11. To ***recruit, train, nurture and retain highly motivated staff with the necessary professional, managerial and customer focus skills***. This includes ensuring the team have the correct skills and competences to deliver the ever increasing complexities of the LGPS scheme.

12. To ***continually review the effectiveness of the committees and advisers*** and the decision making process.

**Funding & Actuarial Matters**

13. To ***achieve a relatively stable "real" investment return above the rate of inflation*** over the long term, in such a way as to minimise and stabilise the level of contributions required to be paid into the Fund by employer bodies in respect of both past and future service liabilities and ***to achieve a 100% funding level over a suitable timescale***. This includes setting of appropriate investment strategies; the appointment of

[2] WPF Funding Strategy Statement January 2019

capable investment managers; and the monitoring and reporting of investment managers' performance, with appropriate action being taken in the event of underperformance.

**Investments and Accounting**

14. To ***ensure the proper administration, accounting and reporting of all the Fund's financial affairs***.

15. To set out clear and ***well regarded Statement of Accounts and Annual Report*** that enables the members and stakeholders of the Fund to understand the latest and future financial position.

**Engagement, Communications / Customer & Employer Relations**

16. The development of ***robust engagement strategy*** with our employers and members.

17. The ***communication of the key benefits of the LGPS and ensuring increased awareness amongst the eligible membership of their benefits***. This includes effective communication, to both the Fund's scheme members and employer bodies.

18. To have in ***place effective documented business relationships with all the Fund's employer bodies***, and to ensure regular reviews are carried out to assess the risk and strength of covenant to the WPF.

**Pensions Administration**

19. To ***provide a lean, effective, customer friendly benefits administration service***, through the calculation and payment of scheme benefits accurately and promptly in line with the published pension administration strategy.

20. The maintain ***an effective administration system*** for the ***accurate maintenance of the records of all members of the Fund***; and to continually review and cleanse this data ensuring it meets the Pension Regulators requirements, and supporting employers to ensure they provide the correct information on submission.

21. To ***optimise the use of technology to make processes more efficient and effective***, and continually looking at developing services in the most cost-effective manner following careful consideration of business cases. This will include increased drive towards greater self-service provision for employers and employees, as well as less paper.

22. To ***become a role model of best practice amongst LGPS Funds*** and to be recognised by our customers as providing an excellent service.

23. To work ***collaboratively and in partnership with both internal and external organisations*** to provide higher quality services at a lower cost.

24. To ***develop and implement a strong workforce strategy*** that directs the future workforce scale and skills, allowing appropriate investment.

25. The Administering Authority use Altair's imaging system which ***supports a paperless*** environment and support flexible working practices for staff.

26. The Administering Authority ***supports a range of projects and business as usual activities such as the actuarial triennial valuation***, policy reviews, committee member and officer training, and contract reviews along with greater emphasis on performance monitoring for the Fund and employers to adhere to.

27. The Fund will ***continue to engage with its stakeholders***, maximising self - service and digitisation, seeking feedback and developing approaches which support our goals.

**Oversight of Delivery**

28. Attached at Appendix 1 is an outline of a developing operational plan that will feed into the five key work streams to develop the business plan. It is proposed that a more detailed analysis is brought back to the next Committee and then regular monitoring of progress and key performance indicators comes to both the Committee and the Pension Board as appropriate.

**Legal, Financial and HR Implications**

29. The Business Plan will drive and be supported by the Fund's medium term financial plan that is considered elsewhere on the same agenda. A key goal is to develop a workforce strategy that will support a strong focus on the scale and skills of the future workforce.

**Privacy Impact Assessment**

30. None

**Equality and Diversity Implications**

31. None

**Contact Points**

County Council Contact Points
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Worcestershire Hub: 01905 765765

Email: worcestershirehub@worcestershire.gov.uk

Specific Contact Points for this report
Michael Hudson, Chief Financial Officer

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**Supporting Information**

Appendix 1 – Outline action programmes for 2019/20 to deliver the Pension Fund Business Plan.

**Background Papers**
In the opinion of the Proper Officer (in this case the Chief Financial Officer) the following are background papers to this report:

**Key Policy Documents**
Key policy documents which the reader may wish to refer to are available on the Worcestershire Pension Fund website:
http://www.worcestershire.gov.uk/info/20408/worcestershire_pension_fund

- Funding Strategy Statement
- Statement of Investment Principles
- Communications Statement
- Administration Strategy
- Cessation Policy
- Administration Authority Discretions
- Annual Statement of Accounts

WPF/BaCl/March 2019

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**AGENDA ITEM 12**

**Appendix 1**

## Outline action programmes for 2019/20 to deliver the Pension Fund Business Plan.

| V5 WPF Operational Plan: Projects dated 13 02 2019 | Lead | Start | Feb-19 | Mar-19 | Apr-19 | May-19 | Jun-19 | Jul-19 | Aug-19 | Sep-19 | Oct-19 | Nov-19 | Dec-19 | Jan-20 | Feb-20 | Mar-20 | Comments |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **1 GMP reconciliation and rectification (310319)** | BC | Apr18 | | Cttee | | | | | | | | | | | | | 28 11 18 Cttee decision |
| **2 GMP equalisation (TBD)** | BC | TBC | | | | | | | | | | | | | | | awaiting guidance |
| **3 Pension Administration Strategy (010419)** | CF | Oct18 | Con-sult | Cttee | publish | | | | | | | | | | | | Employer consultation to 27/2/19 |
| **4 Branding and digital develop (TBD)** | CF | Oct18 | | | | | Cttee | | | | | | | | | | In development |
| **5 Actuarial valuation / FSS / admiss + term pol (310320)** | RW | Apr19 | Data qual. | Cttee | Admin Forum | | | | Prelim | | Admin Forum | FSS | | | | FSS | Ongoing dialogue with stakeholders and Actuaries |
| **6 2019 Investment Strategy Statement (31 03 20)** | RW | Nov18 | | Cttee | | | | | | | | FSS | | | | | Asset allocation review underway |
| **7 Review of Asset Allocation (30 11 19)** | RW | Nov18 | Panel | Cttee | | | | | Prelim | | Panel | Cttee | | | | | Hymans work reporting |
| **8 Pension admin system procurement (TBD)** | BC | Oct18 | Option review | Cttee | | | | | | | | | | | | | Extend with new cloud option |
| **9 Enveloping procurement (310719)** | BC | Aug18 | interim | | spec | | | End | | | | | | | | | In progress |
| **10 Transition assets to LGPS Central Limited (various)** | RW | Feb19 | | | | EM transfr | | | | | | | | | | | In progress |
| **11 LGPS Central budget (various)** | RW | Oct17 | | Cttee | | | Cttee | | | | | Cttee | | Cttee | | | In progress |
| **12 Annual Report & Accounts / associated docs (300919)** | RW | Jan19 | | Cttee | | Audit | Cttee | | | Pub lish | | | | | | | In progress |
| **13 Review data quality (TPR) (TBD)** | LP | Jan19 | | | | | | | | | | | | | | | Awaiting detailed TPR guidance |

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# AGENDA ITEM 12

| V5 WPF Operational Plan: Projects dated 13 02 2019 | Lead | Start | Feb-19 | Mar-19 | Apr-19 | May-19 | Jun-19 | Jul-19 | Aug-19 | Sep-19 | Oct-19 | Nov-19 | Dec-19 | Jan-20 | Feb-20 | Mar-20 | Comments |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **14 CIPFA benchmarking (310719)** | LP | Jun19 | | | | | | | | | | Cttee | | | | | CIPFA engaged |
| **15 ONS Trans / Bal and Inc / Expend return (quarterly)** | RW | Jan19 | | | ¼ rtn | | | ¼ rtn | | | ¼ rtn | | | ¼ rtn | | | In progress |
| **16 ONS Survey of Pensions Funds Bal sheet (300619)** | RW | May19 | | | | | Ann-ual | | | | | | | | | | Data awaited |
| **17 MCHLG SF3 LGPS Funds account (310819)** | RW | Jul19 | | | | | | | Ann-ual | | | | | | | | Scheduled |
| **18 TPR Occupational Pension Schemes Survey (310319)** | LP | Mar19 | | Annu al | | | | | | | | | | | | | Scheduled |
| **19 CEM benchmarking (310719)** | RW | Jun 19 | | | | | | Ann -ual | | | | Cttee | | | | | Scheduled |
| **20 Assess employer covenants (311219)** | RW | Jul18 | | Cttee | Emp'er conver-sations | | | | | | Issue | Chase | End | | | | In progress |
| **21Deferred annual benefit statements (310819)** | CF | Oct18 | | | | Issue | Res-ponse | | | | | | | | | | Collaborating |
| **22 Employee annual benefit statements (310819)** | CF | Oct18 | | Y/End | | | | | Issue | | | | | | | | Collaborating |
| **23 Pensioner P60s (310519)** | SH | Feb19 | | | | Issue | | | | | | | | | | | Collaborating |
| **24 Payslips reflecting pension increase (300419)** | SH | Feb19 | | | Issue | | | | | | | | | | | | Collaborating |
| **25 Revalue CARE accounts (080419)** | SH | Mar19 | | | System config. | | | | | | | | | | | | Scheduled |
| **26 Provide FRS info (various)** | LP | Feb19 | | collect | Share | | | | | | | | | | | Coll-ect | Scheduled |
| **27 Pension Savings Statements (061019)** | LP | Aug19 | | | | | | | Issue | | | | | | | | |

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**AGENDA ITEM 15**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# WORCESTERSHIRE COUNTY COUNCIL PENSION FUND (WCCPF) GOVERNANCE ARRANGEMENTS AND POLICY REVIEW

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**Recommendation**

**1. The Chief Financial Officer recommends that the Committee:**

**a) Agrees to expand the role of the Investment Sub Committee (formerly known as the Pensions Investment Advisory Panel) and agree to the draft Terms of Reference for the Investment Sub Committee and Pensions Committee attached as Appendix 1;**

**b) Agrees the updates required to take on board the monitoring required for LGPS Central Ltd;**

**c) Approves the revised and updated Governance Policy Statement attached as Appendix 2;**

**d) Seeks the approval of Council to the updated terms of reference for the Committee and the updated Governance Policy Statement; and**

**e) Agrees the proposed change of name from Worcestershire County Council Pension Fund to Worcestershire Pension Fund and note the revised Logo.**

**Review of Governance Arrangements**

2. The Committee, the LGPS and the Fund fall under the responsibility of the Pension Regulator and must therefore adhere to their own codes of practice. This Fund continues to be subject to scrutiny at a national level from the Scheme Advisory Board along with its own Local Pensions Board.

3. The Committee has already seen during the past year more focus and scrutiny falling on governance and administration through reports relating to the Government Actuary Department, Guaranteed Minimum pensions, Stewardship code, covenant monitoring, LGPS Central updates to name but a few. This is alongside the investment and funding performance and hence officers will need to ensure greater agenda time is allocated to these issues.

4. Also, Officers feel that it is crucial to make timely investment decisions for instance on the process of transitioning assets to LGPS Central or changes to the existing investment mandates. The table below provides examples of the decisions that would be

taken at the proposed Investment Sub Committee and those at Pensions Committee if this proposal was agreed

**Table showing examples of proposed decisions to be made at the Investment Sub Committee, Pensions Committee and at an Officer level**

| Decision to be made at ISC | ISC | PC | Officer |
|---|---|---|---|
| PEL Investment Performance Report | ✓ | | |
| Fund Managers placed on watch | ✓ | | |
| Fund Managers termination | | ✓ | |
| Monitoring of Fund Managers | ✓ | | |
| Equity Protection monitoring and implementation of strategy within agreed risk parameters | ✓ | | |
| Equity Protection strategy agreement | | ✓ | |
| Appointment of Investment Advisor | | | ✓ |
| Approve amendments to investment mandates within existing return and risk parameters | ✓ | | |
| Review and agree Investment Strategy | | ✓ | |
| Reviewing strategic and emerging opportunities outside the strategic asset allocation and make recommendations to the Committee | ✓ | | |
| Approve transition of Investments to LGPS Central | | ✓ | |
| Monitoring of the transition of investments to LGPS Central | ✓ | | |

5. Therefore, officers believe that through extending the remit of the current Pensions Investment Advisory Panel (to be renamed the Investment sub committee (ISC)) would increase the timeliness and effectiveness of some aspects of investment decision making process as well as releasing more time for discussion on key pension committee items.

6. This proposal would mean that the ISC would meet in public quarterly ahead of the main Committee meetings to review manager performance and make decisions within the agreed strategic asset allocations.

*Expanded Role of the Pensions Investment Sub-Committee (ISC)*

7. The expanded role of the ISC would consider in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives. The ISC may also be requested by this Committee to undertake research and report back on specific investment areas. The attached draft Terms of Reference (see Appendix 1 re the proposed Governance Policy Statement) is summarised below:

*Membership*

8. The membership of ISC would consist of 4 voting members who will be appointed for 1 year:

- 3 Worcestershire County Councillors
- 1 co-opted Councillor as nominated by Herefordshire Council (being the second largest employer in the Fund)

Non-Voting
- 1 employee representative from a relevant Union.

9. The 3 County Councillor members are formally appointed by the Head of Legal and Democratic Services in accordance with political balance requirements from time to time and the nominations of the relevant Group Leaders. The co-optees are co-opted by the Chairman of the Committee.

10. The ISC will be advised by an Independent Financial Adviser who will attend all meetings and on an ad hoc basis by the Fund's Actuary.

*Remit*
11. It is the intention is to make the ISC responsible for the following:

a) Reviewing strategic and emerging opportunities outside the strategic asset allocation and make recommendations to the Committee;
b) Reporting regularly to Committee on the performance of investments, transition of assets and matters of strategic importance;
c) Monitor investment managers' investment performance and recommend decision to terminate mandates on performance grounds to Committee; and
d) Researching and providing a report back to the Worcestershire County Council Pension Fund Committee on any specific investment areas requested.

12. It's proposed the ISC will have delegated authority to:

a) Approve and monitor tactical positions within strategic allocation ranges;
b) Implement investment management arrangements in line with strategic policy, including the agreed transition of assets, setting of mandate parameters and the appointment of managers;
c) Approve amendments to investment mandates within existing return and risk parameters; and
d) Delegate specific decisions to officers as appropriate.

*Reporting*
13. The minutes of the ISC meetings (whether or not approved by the ISC) would appear as an item on the next agenda of the meeting of this Committee that follows.

*Funding*
14. The current Pensions Investment Advisory Panel already meets 4 times a year and therefore the only anticipated additional costs that this proposed revised arrangement will incur is additional Committee Services recharges of £1,200 and printing of approximately £500 per annum.

## Governance Policy Background

15. Regulation states, and best practice dictates, that a Pension Fund should have a range of written policies and procedures in place. Having such not only proves regulatory compliance, but more importantly demonstrates good governance and provides a range of information to stakeholders. This report provides an update to the Governance Policy Statement.

*Governance Policy Statement*

16. **Regulation 55** of the Local Government Pensions Scheme Regulations 2013 states: 55. - (1) An administering authority must prepare a written statement setting out-

a) whether the authority delegates its functions, or part of its functions under these Regulations to a committee, a sub-committee or an officer of the authority;
b) if the authority does so:

    i. the terms, structure and operational procedures of the delegation,
    ii. the frequency of any committee or sub-committee meetings,
    iii. whether such a committee or sub-committee includes representatives of Scheme employers or members, and if so, whether those representatives have voting rights;

c) the extent to which a delegation, or the absence of a delegation, complies with guidance given by the Secretary of State and, to the extent that it does not so comply, the reasons for not complying;
d) Details of the terms, structure and operational procedures relating to the local pension board established under regulation 106 (local pension boards: establishment);
e) An administering authority must keep a statement prepared under paragraph (1) under review, and make such revisions as are appropriate, following a material change to any of the matters mentioned in that paragraph;
f) Before preparing or revising a statement under this regulation, an administering authority must consult such persons as it considers appropriate; and
g) An administering authority must publish its statement under this regulation, and any revised statement.

17. The Governance Policy Statement was last updated on the 12 February 2015 to reflect the introduction of the Local Pensions Board in 2015. The latest version attached as Appendix 2 has been reformatted slightly and has also been updated to reflect the proposed changes to the governance arrangements for the Pensions Investment Sub Committee and LGPS Central Limited. As the statement reflects the actual Governance arrangements in place, no wider consultation is considered necessary.

## New Brand and Logo

18. To present us as a more modern organisation open to new ideas, we propose changing the name from **Worcestershire County Council Pension Fund** to **Worcestershire Pension Fund**.

19. The subtle change would not only mean that the name is snappier but also indicates the willingness to move the organisation forward in any direction that could benefit the Fund's stakeholders.

20. The change of name would be supported by a change in logo which is detailed below:


**Contact Points**

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Worcestershire Hub: 01905 765765

Specific Contact Points for this report

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**Supporting information**
Appendix 1 - Revised Terms of Reference for the Pensions Committee and Investment Sub Committee
Appendix 2 – Updated Governance Policy Statement

**Background Papers**
In the opinion of the proper officer (in this case the Chief Financial Officer). There are no background papers relating to the subject matter of this report.

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# Worcestershire County Council Pension fund

## Proposed Terms of reference for the Pensions Committee and Pensions Investment Sub Committee

**19 March 2019**

1 **Pension Committee Terms of Reference**:

1.1. The Pension Committee will meet at least quarterly or otherwise as necessary to take decisions on:

- Changes to the Investment Strategy Statement, including the strategic benchmark for asset allocation, Investment Manager benchmarks and Investment Manager targets.
- Transition of investments to LGPS Central or other Pooling arrangements
- The termination and appointment of Investment Managers and associated professional service providers.
- The termination and appointment of the Fund's Independent Financial Adviser, Performance Measurement Consultant, Global Custodian and Actuary.
- The Pensions Administration Strategy Statement, Policy Statement on Communication Strategy, Policy Statement on Governance Strategy, Funding Strategy Statement and Governance Compliance Statement.
- The Triennial and Interim Actuarial Valuations.
- The approval of the Pension Fund Annual Report and Accounts.
- The approval of the Pension Fund annual and triennial budgets.
- Key outstanding risks as identified in the Pension Fund Risk Register.
- The Pension Administration Advisory Forum arrangement and regular Forum reports, which consider and address outstanding member and employer issues and concerns.
- The Pension Sub Committee arrangement and regular Sub Committee reports, which monitor performance of the Fund's assets.
- Requests for admission of qualifying Community and Transferee Bodies wishing to join the Fund.
- Key pension policy discretions that are the responsibility of the Administering Authority.

1.2. All elected members and voting co-optees of the Pensions Committee are subject to the Worcestershire County Council Code of Conduct for Members, and must therefore register and keep updated their Disclosable Pecuniary Interests as required by the law and Code and disclose potential conflicts of interest as required by that Code.

1.3. Members of the Pensions Committee are expected to hold the appropriate knowledge and skills to discharge their responsibility effectively.

1.4. The responsibility for advising the Pensions Committee is delegated to the Chief Financial Officer.

1.5. Members of the Pensions Committee have equal access to Pensions Committee agenda papers and associated appendices in accordance with the legislation and constitutional Rules relating to access to information for committees. Formal meetings of the Committee will take place in public unless it has resolved to move into exempt session in accordance with the applicable access to information provisions.

1.6. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 formally introduced the concept of asset pooling. Over time, as assets move into pooled structures the Pensions Committee will also become responsible for:

.

- The selection, appointment and dismissal of an investment pooling operator to manage the assets of the Fund;
- Determining what the administering authority requires the pool to provide to enable it to execute its local investment strategy effectively;
- Receiving and considering reports and recommendations from the Joint Committee and Practitioners Advisory Forum, established to oversee the pool, to ensure that the Fund's investor rights and views are represented effectively;
- Identifying and managing the risk associated with investment pooling;
- Ensuring that appropriate measures are in place to monitor and report on the ongoing costs of investment pooling; and
- Ensuring the responsible investment, corporate governance and voting policies of the Fund are delivered effectively.

## 2. Worcestershire County Council Pension Investment Sub Committee (ISC)

2.1 The role of the Worcestershire County Council Pension Fund Investment Sub-Committee shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives.

2.2 The Council appoints the Chairman and Vice-Chairman of the Pension Investment Sub Committee. The Chairman of the particular meeting has a second or casting vote in the case of equality of votes.

2.3 The Pension Investment Sub Committee is a formal committee of the Council and comprises a total of 4 voting members:

- 3 Worcestershire County Councillors
- 1 co-opted Councillor as nominated by Herefordshire Council (being the second largest employer in the Fund)
  Non-voting
- 1 employee representative from a relevant Union.

2.4 The 3 County Councillor members are formally appointed by the Head of Legal and Democratic Services in accordance with political balance requirements from time

to time and the nominations of the relevant Group Leaders and the co-optees are co-opted by the Chairman of the Committee.

2.5 The ISC will be advised by an Independent Financial Adviser who will attend all meeting and on an ad hoc basis by the Fund's Actuary

2.6 The composition of the Pension Investment Sub Committee is intended to reflect the abilities and knowledge of the individuals in matters relating to the investment of the Fund's assets rather than political representation. All members of the Sub Committee are entitled to vote if necessary for the Panel to fulfil its role and provide advice to the Pension Committee regarding the administration of the fund's assets.

2.7 The responsibility for advising the Pension Committee is delegated to the Chief Financial Officer.

**Terms of reference**:

2.8 The role of the Worcestershire County Council Pension Fund Investment Sub-Committee shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives.

2.9 The ISC may also be occasionally requested to by the Worcestershire County Council Pension Fund Committee to undertake research and report back on a specific investment areas.

2.10 All decision taken and recommendations will be reported back to the next available ordinary meeting of the Worcestershire County Council Pension Fund Committee in the form of the minutes of the ISC.

2.11 The ISC, will be responsible for:

a. Reviewing strategic and emerging opportunities outside the strategic asset allocation and make recommendations to the Committee.
b. Reporting regularly to Committee on the performance of investments and matters of strategic importance.
c. Monitor investment managers' investment performance and recommend decision to terminate mandates on performance grounds to Committee.
d. Monitor the Transition of investments to LGPS Central or other Pooling arrangements
e. Researching and providing a report back to the Worcestershire County Council Pension Fund Committee on any specific investment areas requested.

The ISC will have delegated authority to:

f. Approve and monitor tactical positions within strategic allocation ranges.
g. Implement investment management arrangements in line with strategic policy including the setting of mandate parameters and the appointment of managers.
h. Approve amendments to investment mandates within existing return and risk parameters.

i. Delegate specific decisions to officers as appropriate.

2.12 The ISC would meet quarterly ahead of the main Committee meetings to review manager performance and make decisions within the strategic asset allocations agreed.

2.13 The ISC is advised by an Independent Financial Adviser who attends all meetings and on an ad hoc basis by the Fund's Actuary.

2.14 One of the regular quarterly meetings will include an annual meeting to consider the Fund's full year's performance.

2.15 The Fund's Investment Strategy Statement (ISS) sets out the arrangements in place for the management of the investments of the Worcestershire County Council Pension Fund.

2.16 The day to day management of the Fund's investments is divided between external Investment Managers, operating in accordance with mandates set out in the Investment Strategy Statement.

2.17 The Chairman of the Investment Sub Committee will attend the Pension Committee to ensure flow of information between the 2 bodies.

2.18 Members of ISC must not have a conflict of interest and are required to provide the Chief Financial Officer with such information as the Chief Financial Officer reasonably requires for the purposes of ensuring no conflict of interest exists prior to appointment to the ISC and on an ongoing annual basis.

2.19 Members of the ISC are required to hold the appropriate knowledge and skills to discharge their responsibility effectively.

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# Worcestershire County Council Pension fund

# Governance Policy Statement

19th March 2019

## 1. Introduction

1.1 The Worcestershire County Council Pension Fund administers the Local Government Pension Scheme for its own employees and employees and those of over 200 other Scheme Employers in the administrative area of Herefordshire and Worcestershire, with 22,000 contributing members, 17,000 pensioners and beneficiaries and a further 20,000 deferred pensioners.

1.2 The Local Government Pension Scheme (LGPS) regulations require all administering authorities to publish a Governance Policy Statement which sets out how the County Council discharges its responsibilities in response to the regulatory requirements.

1.3 This statement combines the overall governance arrangements which meet the requirements set out in Part 2 (Administration) Regulation 55 and Part 3 (Governance) Regulation 106 of LGPS Regulations 2013.

1.4 This statement also takes account of the guidance issued by Ministry of Housing, Communities and Local Government (MHCLG) entitled Local Government Pension Scheme Governance Compliance Statement Statutory Guidance. The basic principles are accountability and transparency and both principles are achieved by setting clear responsibilities and appropriate reporting mechanisms.

1.5 Further sources of information are available on the Fund's website worcestershire.gov.uk/pensions including the Annual Report and Accounts, Funding Strategy Statement and Investment Strategy Statement.

## 2. Purpose of the Governance Policy Statement

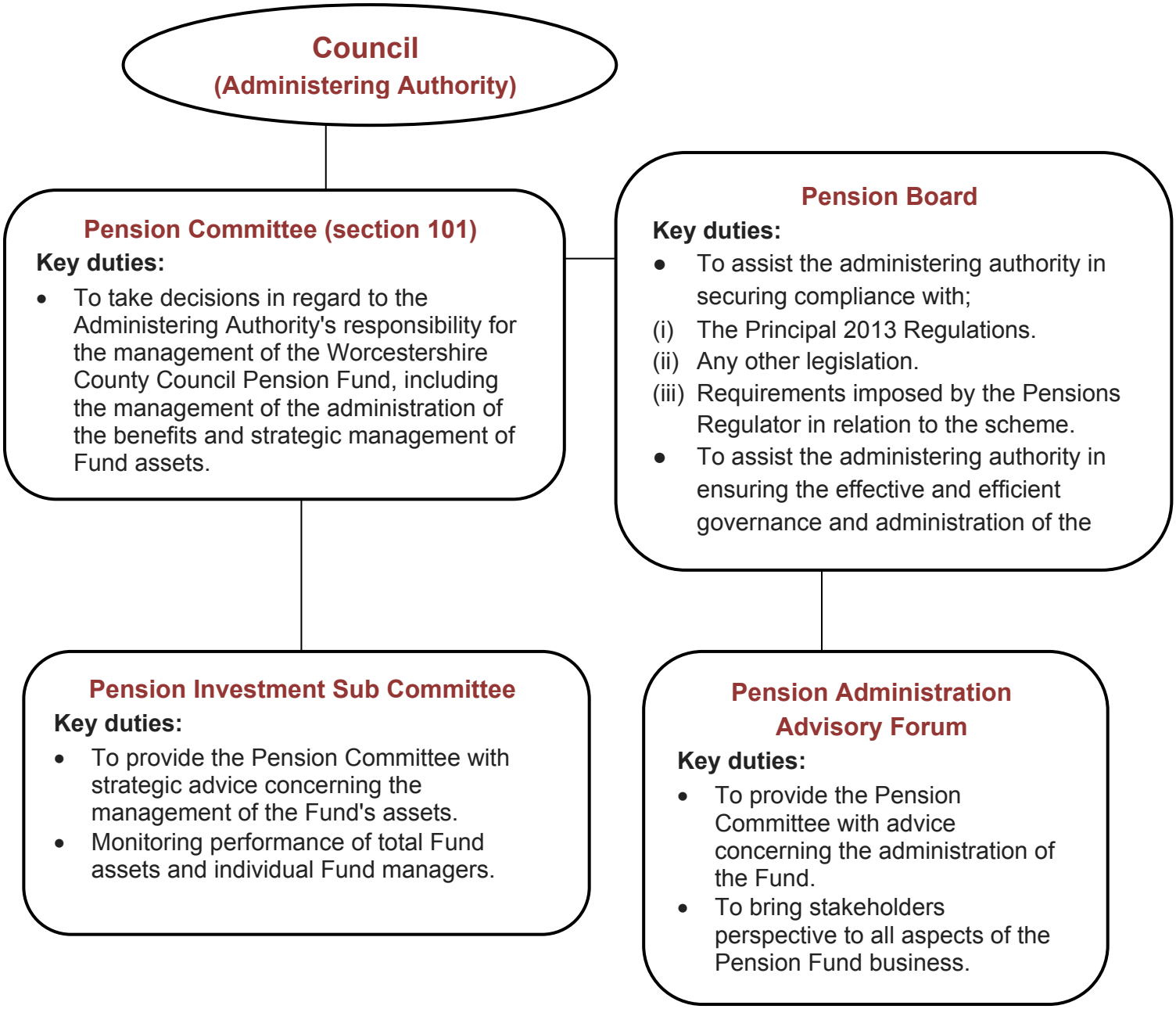
2.1 The LGPS regulations require an administering authority, after consultation with such persons as they consider appropriate, to prepare, maintain, publish and keep under review a written statement setting out:

- whether it delegates its functions, or part of its functions under these Regulations to a committee, a sub-committee or an officer of the authority;
- the terms, structure and operational procedures of the delegation;
- whether such a committee or sub-committee includes representatives of Scheme employers or members, and if so, whether those representatives have voting rights;
- the extent to which a delegation, or the absence of a delegation, complies with guidance given by the Secretary of State and, to the extent that it does not so comply, the reasons for not complying; and
- Details of the terms, structure and operational procedures relating to the Local Pension Board.

**3. Governance of the Worcestershire County Council Pension Fund**

3.1 Overall responsibility for managing the Fund lies with the full Council of Worcestershire County Council Pension Fund in its role as administering authority. Under the County Council's Constitution, further delegations for the management, administration and investment of the Fund are made to the Pensions Committee, the Pensions Panel and the Chief Financial Officer and his Staff.

## Governance Structure of the Worcestershire County Council Pension Fund




*In all areas of the Governance Structure, the 7 Principles of Public Life (Selflessness, Integrity, Objectivity, Accountability, Openness, Honesty and Leadership) are widely acknowledged and practiced; both within the decision-making framework and within day to day activities.*

## 4. Administrative Arrangements

4.1 On 1 April 1998 Worcestershire County Council was constituted and vested, under section 16 of the Hereford and Worcester (Structural, Boundary and Electoral Changes) order 1996 (Statutory Instrument 1996 No 1867), with the rights and liabilities of the former pension fund Hereford and Worcester County Council. Therefore, the Council is the appropriate Administering Authority to maintain the Fund.

4.2 As the statutory Administering Authority and Scheme Manager for the Fund, Worcestershire County Council is responsible for ensuring effective stewardship of the Fund's affairs. Worcestershire County Council has established a Pension Committee to discharge the Council's responsibility for the management of the administration of the Fund.

4.3 Worcestershire County Council has also established a Pension Investment Advisory Panel to provide the Pension Committee with strategic advice concerning changes to the Fund's asset allocation, the termination and appointment of investment managers and Independent Financial Advisers.

4.4 A Pension Administration Advisory Forum has also been established to provide wider stakeholder representation and communication in matters relating to the Fund. The Pension Committee has overall responsibility for the management of the administration of the Fund, as set out in the Scheme of Assignment of Responsibility for Functions, however the Pension Committee takes advice from the Pension Administration Advisory Forum to enable the Pension Committee to discharge its responsibility effectively.

## 5. Pensions Committee

5.1 The Pensions Committee discharges the responsibilities of the Council as Administering Authority of the Fund pursuant to Section 101 and Regulations under Section 7 of the Superannuation Act 1972.

5.2 The Pensions Committee discharges the responsibilities for management of the administration of the Fund. However it will take views from the Investment sub committee to enable it to discharge its duties effectively.

5.3 The Pensions Committee discharges the responsibilities for the strategic management of the Fund's assets. However, it will take strategic advice from the Investment Sub Committee to enable it to discharge its duties effectively. The dates of Pension Committee meetings will be synchronised with those of the Pension Sub Committee to ensure investment decisions are reviewed without unnecessary delay.

5.4 The Council appoints the Chairman and Vice-Chairman of the Pensions Committee. The Chairman of the particular meeting has a second or casting vote in the case of equality of votes.

5.5 The Pension Committee is a formal committee of the Council and comprises a total of 8 voting members:

- 5 Worcestershire County Councillors
- 1 co-opted Councillor as nominated by Herefordshire Council (being the second largest employer in the Fund)
- 1 co-opted voting employer representative and
- 1 co-opted voting employee representative from a relevant Union.

5.6 The 5 County Councillor members are formally appointed by the Head of Legal and Democratic Services in accordance with political balance requirements from time to time and the nominations of the relevant Group Leaders and the 3 co-optees are co-opted by the Chairman of the Committee.

5.7 The Pension Committee will be advised by on an ad hoc basis by an Independent Financial Adviser and the Fund's Actuary.

5.8 **Pensions Committee Terms of Reference**:

The Pensions Committee will meet at least quarterly or otherwise as necessary to take decisions on:

- Changes to the Investment Strategy Statement, including the strategic benchmark for asset allocation, Investment Manager benchmarks and Investment Manager targets.
- Transition of investments to LGPS Central or other Pooling arrangements
- The termination and appointment of Investment Managers and associated professional service providers.
- The termination and appointment of the Fund's Independent Financial Adviser, Performance Measurement Consultant, Global Custodian and Actuary.
- The Pensions Administration Strategy Statement, Policy Statement on Communication Strategy, Policy Statement on Governance Strategy, Funding Strategy Statement and Governance Compliance Statement.
- The Triennial and Interim Actuarial Valuations.
- The approval of the Pension Fund Annual Report and Accounts.
- The approval of the Pension Fund annual and triennial budgets.
- Key outstanding risks as identified in the Pension Fund Risk Register.
- The Pension Administration Advisory Forum arrangement and regular Forum reports, which consider and address outstanding member and employer issues and concerns.
- The Pension Sub Committee arrangement and regular Sub Committee reports, which monitor performance of the Fund's assets.
- Requests for admission of qualifying Community and Transferee Bodies wishing to join the Fund.
- Key pension policy discretions that are the responsibility of the Administering Authority.

5.9 All elected members and voting co-optees of the Pension Committee are subject to the Worcestershire County Council Code of Conduct for Members, and must therefore register and keep updated their Disclosable Pecuniary Interests as required by the law and Code and disclose potential conflicts of interest as required by that Code.

5.10 Members of the Pensions Committee are expected to hold the appropriate knowledge and skills to discharge their responsibility effectively – see Section 8.

5.11 The responsibility for advising the Pension Committee is delegated to the Chief Financial Officer.

5.12 Members of the Pensions Committee have equal access to Pensions Committee agenda papers and associated appendices in accordance with the legislation and constitutional Rules relating to access to information for committees. Formal meetings of the Committee will take place in public unless it has resolved to move into exempt session in accordance with the applicable access to information provisions.

5.13 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 formally introduced the concept of asset pooling. Over time, as assets move into pooled structures the Pensions Committee will also become responsible for:

.

- The selection, appointment and dismissal of an investment pooling operator to manage the assets of the Fund;
- Determining what the administering authority requires the pool to provide to enable it to execute its local investment strategy effectively;
- Receiving and considering reports and recommendations from the Joint Committee and Practitioners Advisory Forum, established to oversee the pool, to ensure that the Fund's investor rights and views are represented effectively;
- Identifying and managing the risk associated with investment pooling;
- Ensuring that appropriate measures are in place to monitor and report on the ongoing costs of investment pooling; and
- Ensuring the responsible investment, corporate governance and voting policies of the Fund are delivered effectively.

## 6. Pension Board

Please see separate Pension Board Terms of Reference document.

## 7. Worcestershire County Council Pension Investment Sub Committee (ISC)

7.1 The role of the Worcestershire County Council Pension Fund Investment Sub-Committee shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives.

7.2 The Council appoints the Chairman and Vice-Chairman of the Pension Investment Sub Committee. The Chairman of the particular meeting has a second or casting vote in the case of equality of votes.

7.3 The Pension Investment Sub Committee is a formal committee of the Council and comprises a total of 4 voting members:

- 3 Worcestershire County Councillors

- 1 co-opted Councillor as nominated by Herefordshire Council (being the second largest employer in the Fund)
  Non-voting
- 1 employee representative from a relevant Union.

7.4 The 3 County Councillor members are formally appointed by the Head of Legal and Democratic Services in accordance with political balance requirements from time to time and the nominations of the relevant Group Leaders and the co-optees are co-opted by the Chairman of the Committee.

7.5 The ISC will be advised by an Independent Financial Adviser who will attend all meeting and on an ad hoc basis by the Fund's Actuary

7.6 The composition of the Pension Investment Sub Committee is intended to reflect the abilities and knowledge of the individuals in matters relating to the investment of the Fund's assets rather than political representation. All members of the Sub Committee are entitled to vote if necessary for the Panel to fulfil its role and provide advice to the Pension Committee regarding the administration of the fund's assets.

7.7 The responsibility for advising the Pensions Committee is delegated to the Chief Financial Officer.

**Terms of reference**:

7.8 The role of the Worcestershire County Council Pension Fund Investment Sub-Committee shall be to consider, in detail matters relating to the investment of the assets within the strategic investment framework and performance of investment managers in achieving the Fund's investment objectives.

7.9 The ISC may also be occasionally requested to by the Worcestershire County Council Pension Fund Committee to undertake research and report back on a specific investment areas.

7.10 All decision taken and recommendations will be reported back to the next available ordinary meeting of the Worcestershire County Council Pension Fund Committee in the form of the minutes of the ISC.

7.11 The ISC, will be responsible for:-

a. Reviewing strategic and emerging opportunities outside the strategic asset allocation and make recommendations to the Committee.
b. Reporting regularly to Committee on the performance of investments and matters of strategic importance.
c. Monitor investment managers' investment performance and recommend decision to terminate mandates on performance grounds to Committee.
d. Monitor the Transition of investments to LGPS Central or other Pooling arrangements
e. Researching and providing a report back to the Worcestershire County Council Pensions Committee on any specific investment areas requested.

The ISC will have delegated authority to:

f. Approve and monitor tactical positions within strategic allocation ranges.
g. Implement investment management arrangements in line with strategic policy including the setting of mandate parameters and the appointment of managers.
h. Approve amendments to investment mandates within existing return and risk parameters.
i. Delegate specific decisions to officers as appropriate.

7.12 The ISC would meet quarterly ahead of the main Committee meetings to review manager performance and make decisions within the strategic asset allocations agreed.

7.13 The ISC is advised by an Independent Financial Adviser who attends all meetings and on an ad hoc basis by the Fund's Actuary.

7.14 One of the regular quarterly meetings will include an annual meeting to consider the Fund's full year's performance.

7.15 The Fund's Investment Strategy Statement (ISS) sets out the arrangements in place for the management of the investments of the Worcestershire County Council Pension Fund.

7.16 The day to day management of the Fund's investments is divided between external Investment Managers, operating in accordance with mandates set out in the Investment Strategy Statement.

7.17 The Chairman of the Investment Sub Committee will attend the Pension Committee to ensure flow of information between the 2 bodies.

7.18 Members of ISC must not have a conflict of interest and are required to provide the Chief Financial Officer with such information as the Chief Financial Officer reasonably requires for the purposes of ensuring no conflict of interest exists prior to appointment to the ISC and on an ongoing annual basis.

7.19 Members of the ISC are required to hold the appropriate knowledge and skills to discharge their responsibility effectively.

## 8. Pension Administration Advisory Forum

8.1 The Pension Administration Advisory Forum provides the Pension Committee with advice concerning the administration of the Fund. It is neither a decision-making body nor formal committee, and will not normally meet in public. No voting rights apply to the Pension Administration Advisory Forum as the purpose of the Forum is to provide transparency of information to scheme employers and for scheme employers to provide advice to, and raise concerns with, the employer representative.

8.2.1 The Pension Administration Advisory Forum comprises:

- all Fund employers who wish to attend following invitation by the Administering Authority
- the Fund's Actuary (ad hoc basis)
- the Administering Authority's Pensions Manager and HR Service Centre Manager
- and the employer representative and employee representative of the Pensions Committee.

**Terms of reference**:

8.3 The Forum will meet at least twice a year or otherwise as necessary to:

- Discuss an Annual Administration Report and respond to any issues raised by employers.
- Discuss Government Consultations relating to the administration and benefits of the LGPS.
- Discuss the outcomes of the triennial/interim valuations and respond to any issues raised by employers.
- Discuss the minutes and updates from the Pension Committee and ensure flow of information between the Pension Committee and the Forum.
- To advise on service delivery to all stakeholders.
- To bring stakeholders perspective to all aspects of the Pension Fund business.
- To ask the Administering Authority and the Pension Committee to consider topics which affect the Pension Fund.

.

8.4 All Fund employers are invited to attend the Pension Administration Advisory Forum along with the Fund's Actuary, Administering Authority officers and the employer and employee representatives on the Pension Committee.

8.5 Other meetings are held as required between Administering Authority officers and employers to discuss important issues such as discretionary policies and regulatory changes.

8.6 The Administering Authority also communicates with the Fund's membership through newsletters, road shows and presentations.

8.7 The Fund’s Policy Statement on Communication Strategy explains in more detail engagement with all stakeholders.

## 9. Delegation

9.1 The day to day administration of, and investment decisions for, the Worcestershire County Council Pension Fund are delegated to the Chief Financial Officer.

9.2 The Chief Financial Officer may authorise other officers to exercise on his/her behalf those functions delegated to him/her.

9.3 The Chief Financial Officer has delegated responsibility for the following responsibilities concerning the management of the administration of the Fund including:

- Preparing and maintaining a Pensions Administration Strategy Statement, Policy Statement on Communication Strategy, and Policy Statement on Governance Strategy, Funding Strategy Statement and Governance Compliance Statement.
- Provision of data for the Triennial and Interim Actuarial Valuations. The Chief Financial Officer will also negotiate over actuarial assumptions, set the appropriate funding target and associated recovery period.
- Preparing the Pension Fund Annual Report and Accounts.
- Preparing the Pension Fund annual and triennial budgets.
- Preparing and maintaining a Pension Fund Risk Register and monitoring key outstanding risks.
- Overseeing and administering the Pension Administration Advisory Forum arrangement and review regular Forum reports to consider and address outstanding member and employer issues and concerns.
- Administering the Pension Investment Sub Committee (ISC) arrangements and reviewing regular ISC reports to monitor performance of the Fund's assets.
- Deciding upon requests for admission of qualifying Community and Transferee Bodies and Scheduled and Designated Bodies wishing to join the Fund.
- Deciding upon key pension policy discretions that are the responsibility of the Administering Authority
- Executing documentation relating to the implementation of new and existing investment mandates, Independent Financial Advisers, Performance Measurement Consultant, Global Custodians, Actuaries and any other associated professional service providers.
- Quarterly monitoring of Investment Managers' performance for managers not presenting to the Pension Investment Advisory Panel.
- The effective discharge of the pensions administration function, including the payment of pensions and collecting and reconciling of contribution income.
- Maintaining the Fund's accounting records.
- Preparing and maintaining the Investment Strategy Statement, including implementing changes to the strategic benchmark for asset allocation.
- Implementing and maintaining a knowledge and skills training plan for members of the Pension Committee and Pension Investment Sub Committee.
- Advising the Pension Committee.
- Implementing and maintaining the cash flow strategy for the Fund, which includes the transfer of cash to the Fund's Global Custodian to ensure cash is fully invested when available and the transfer of cash from the Global Custodian to pay pension liabilities as they fall due.

## 10. LGPS Central (LGPSC)

10.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 formally introduced the concept of asset pooling. As a result of this, the Worcestershire County Council Pension Fund has joined with 8 other

LGPS Funds across the Midlands (Partner Funds) to form an asset pool, known as LGPS Central.

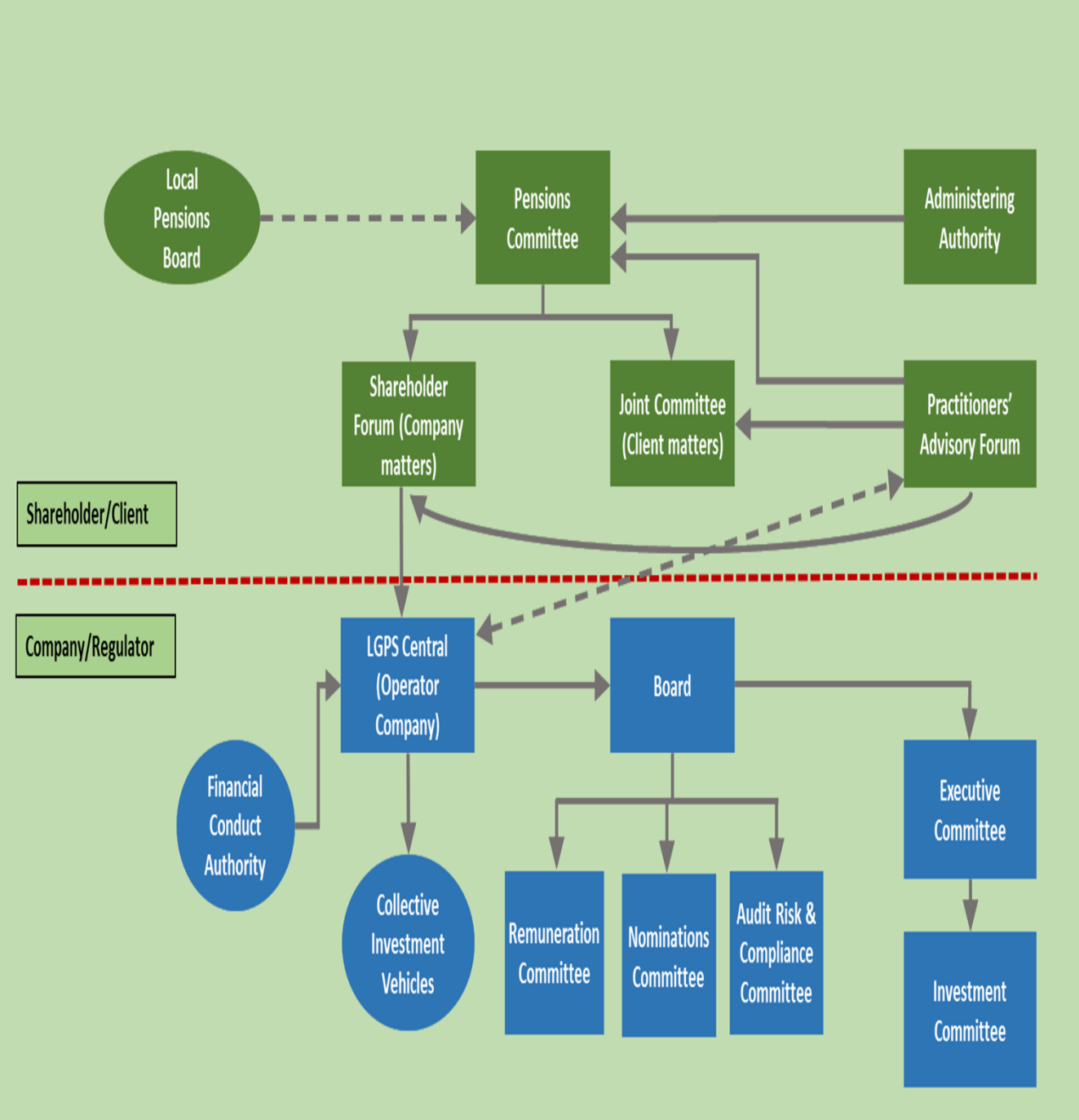
10.2 LGPS Central Limited is the Company formed by the Partner Funds which is authorised as the operator of the Authorised Contractual Scheme (ACS), to provide investment services to the Partner Funds, by the Financial Conduct Authority (FCA). The company is therefore subject to the regulator's conduct of business rules and has established its internal governance framework to ensure strict adherence both to its regulatory obligations to the FCA and with the Companies' Acts.

10.3 It is important to note that the Councils of each of the Partner Funds retain their core duties and responsibilities as the administering authorities of their respective LGPS Funds.

10.4 Asset allocation decisions remain with the Partner Funds. Manager selection for assets transitioned into the ACS and for assets managed under discretionary agreements by the Operator is the responsibility of LGPS Central Limited. Manager selection for the remainder of the Pool's assets currently remains with the Partner Funds. The Operator is responsible for selecting the custodian for the assets in the ACS; the Partner Funds are responsible for selecting the custodian for the remaining assets.

10.5 The formation of LGPS Central Limited on 1 April 2018 will begin to have an impact on the roles of the Worcestershire County Council Pensions Committee and the Pensions Investment Sub Committee. However, changes will be gradual as the transfer of the management activity to the new company progresses. Consequently, the existing Governance arrangements and Terms of Reference need to run concurrently with new terms required to facilitate changes.

# Governance Structure of LGPS Central




10.6 The governance structure of LGPS Central will allow Partner Funds to exercise control (both individually and collectively) over the pooling arrangements; not only as investors in the ACS but also as shareholders of the operator company.

10.7 The **LGPS Central Joint Committee** has been set up in accordance with provisions of the Local Government Act 1972 to provide oversight of the delivery of the objectives of the Pool, the delivery of client service, the delivery against the LGPS Central business case and to deal with common investor issues.

10.8 The membership of the Joint Committee consists of one elected member from each Council within the LGPS Central pool. The first meeting of the Joint Committee took place on 23 March 2018 and at that meeting it was agreed that a Trade Union representative would be appointed as a non-voting member of the Joint Committee to represent the scheme members across the Councils' pension funds.

10.9 Worcestershire County Council representative on the LGPS Central Joint Committee is the Chair of the Pensions Committee.

10.10 The primary role of the **Shareholders' Forum** is to oversee the operation and performance of LGPS Central Ltd and to represent the ownership rights and interests of the Shareholding Councils within the LGPS Central pool. The Shareholders' Forum is independent of the Company and its meetings are distinct from Company meetings, however, members of the Shareholders' Forum represent the Councils at Company Meetings. The Councils as individual investors in the Company have in place local arrangements to enable their Shareholder representatives to vote at Company meetings.

10.11 The Worcestershire County Council Pension Fund, as a shareholder in LGPS Central has equal voting rights alongside the other Partner Funds and unanimous decisions are required on certain reserved matters before the actions can be implemented. These are specified in the Company's Shareholder Agreement and Articles of Association. Other matters, not directly related to the control of the company to manage its operation are subject to a majority approval (75%).

10.12 Worcestershire County Council representative on the Shareholders Forum is the Chair of the Pensions Investment Sub Committee.

10.13 The **Practitioners' Advisory Forum (PAF)** is a working group of officers appointed by the Shareholding Councils within the LGPS Central pool to support the delivery of the objectives of the Pool and to provide support for the Pool's Joint Committee and Shareholders' Forum. PAF seeks to manage the Pool's conflicting demands and interests, either between the participating Councils or between the Councils (collectively) and the Company, recognising that speaking with "one voice" reduces the duplication of costs and resources and maximises the benefits of scale. PAF will also report back to Partner Fund's Pensions Committees on matters requiring their attention.

10.14 Worcestershire County Council representatives on PAF are the Chief Financial Officer and the Finance Manager for Pension Investments and Treasury Management.

10.15 Terms of Reference have been approved for the Joint Committee, the Shareholders' Forum and the Practitioners' Advisory Forum. These are "live" documents which are likely to evolve as the practical day to day experience of working within the LGPS Central pool evolves.

## 11. Knowledge and Skills

11.1 The Administering Authority has regard to the legal requirements set out in the Local Government Pension Scheme Regulations, other relevant legislation and best practice guidance published by CIPFA and other professional and

regulatory bodies in creating a knowledge and skills policy for the Worcestershire County Council Pension Fund, to ensure all those involved in the decision-making process receive relevant training in order to obtain the appropriate knowledge and skills to discharge their responsibilities effectively.

11.2 Committee members and appropriate Administering Authority officers complete an annual knowledge and skills self-assessment form. These are used to prepare annual training plans and a log of training undertaken is maintained by the Administering Authority. The annual training plans include a programme of external and internal training events designed to meet the requirements both of new members of the committee and the ongoing needs of existing members. These events are reported formally to members on an annual basis. Individual reports to authorise attendance by members at these events are put to the Chief Financial Officer on an event by event basis.

## 12. Governance Compliance Statement

12.1 LGPS Regulations require Pension Fund's to issue a statement confirming the extent to which their governance arrangements comply with guidance issued by the Secretary of State. The statement below confirms the mechanism in place to satisfy each requirement.

| Ref. | Principles | Compliance Status | Evidence of Compliance |
|---|---|---|---|
| **A** | **Structure** | | |
| a. | That the management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council. | Compliant | The responsibilities of the Pensions Committee (PC) and its Sub-Groups are set out in the Fund's Governance Policy Statement. The Governance Policy Statement was approved by Full Council |
| b. | That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee. | Compliant | The Pensions Committee membership includes an employee and employer representative. Full membership details are set out in the Fund's Governance Policy Statement. |
| c. | That where a secondary | Compliant | The Pension Investment Sub Committee |

| Ref. | Principles | Compliance Status | Evidence of Compliance |
|---|---|---|---|
| | committee or panel has been established, the structure ensures effective communication across both levels. | | provides strategic advice to the Pension Committee regarding the management of the Fund's assets. The Chairman of the Pensions Committee also sits on the Pension Investment Sub Committee to ensure effective communication. The Pensions Committee receives quarterly investment updates from the Pension Investment Sub Committee. An Administration forum has been established. The employer and employee representatives from the pensions committee attend the forum and there is a standing invitation from the pension board to attend the forum. |
| **B** | **Representation** | | |
| a. | That all key stakeholders have the opportunity to be represented within the main or secondary committee structure. These include:<br>i) employing authorities (including non-scheme employers, e.g., admitted bodies)<br>ii) scheme members (including deferred and pensioner scheme members)<br>iii) where appropriate, independent professional observers, and<br>iv) expert advisers (on an ad-hoc basis). | Compliant | Membership of the Pensions Committee and Pension Investment Sub Committee include employer and employee representatives and an independent financial adviser. Full membership details are set out in the Fund's Governance Policy Statement.<br>Expert advisors attend the Pensions Committee as required for the nature of the main decisions. For example, the Actuary attends when the valuation is being considered, and the main Investment Consultant attends when the Strategic Asset Allocation decision is being made. The Investment Consultant regularly attends the Pensions Investment Sub Committee meeting.<br>All members are treated equally in terms of access to papers and to training that is given as part of the Committee process. |
| **C** | **Selection and role of lay members** | | |

| Ref. | Principles | Compliance Status | Evidence of Compliance |
|---|---|---|---|
| a. | That committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee. | Compliant | The Pensions Committee has noted its terms of reference and the Fund's Governance Policy Statement. Minutes of the Pension Committee meetings are published on the Council's website. A detailed Training programme is also provided to Committee members and Investment sub committee members. |
| b. | That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda. | Compliant | Declaration of interests is a standing agenda item at the start of all Pensions Committee meetings. The Pensions Committee and Investment Sub Committee are serviced by Legal and Democratic Services who invite members to declare any financial or pecuniary interest related to specific matters on the agenda. Minutes of the Pensions Committee and Investment Sub Committee meetings are published on the Council's website. |
| **D** | **Voting** | | |
| a. | That the individual administering authorities on voting rights are clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees. | Compliant | Voting rights are clearly set out in the Fund's Governance Policy Statement. |
| **E** | **Training / facility time / expenses** | | |
| a. | That in relation to the way in which the administering authority takes statutory and related decisions, there is a clear policy on training, facility time and | Compliant | A policy on expenses is set out in the Fund's Governance Policy Statement along with the number of Committee meetings required each year. The Fund has an approved Joint Training Policy for the Pensions Committee, Investment Sub |

| Ref. | Principles | Compliance Status | Evidence of Compliance |
|---|---|---|---|
| | reimbursement of expenses for members involved in the decision-making process. | | Committee and the Local Pension Board |
| b. | That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum. | Compliant | These polices apply to all committee members and this is clearly set out in the Fund's Governance Policy Statement, Knowledge and Skills Policy Statement & the Joint Training Policy for the Pensions Committee, Investment Sub Committee and the Local Pension Board . |
| c. | That the administering authority considers adopting annual training plans for committee members and maintains a log of all such training undertaken. | Compliant | The fund's Knowledge and Skills Policy Statement sets out the requirement for annual training plans to be developed and maintained for committee members and for a log of all such training undertaken to be maintained. Regular feedback on training events is provided to pensions committee |
| **F** | **Meetings (frequency / quorum)** | | |
| a. | That an administering authority's main committee or committees meet at least quarterly. | Compliant | The Pensions Committee meets quarterly. This requirement is set out in the Fund's Governance Policy Statement. |
| b. | That an administering authority's secondary committee or panel meets at least twice a year and is synchronised with the dates when the main committee sits. | Compliant | The Pension Fund Investment Sub Committee meets quarterly. These meetings are synchronised with the dates when the Pension Committee sits. These requirements are set out in the Fund's Governance Policy Statement. The Admin Forum meets twice a year. |
| c. | That an administering authority that does not include lay members in its formal governance arrangements must provide a forum outside of those arrangements to represent | Compliant | The Fund has established a Pension Administration Advisory Panel which meets twice yearly. All Fund employers are invited to attend the Panel meetings. The Panel arrangement and terms of reference are set out in the Fund's Governance Policy Statement. |

| Ref. | Principles | Compliance Status | Evidence of Compliance |
|---|---|---|---|
| | the interests of key stakeholders. | | |
| **G** | **Access** | | |
| a. | That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that are due to be considered at meetings of the main committee. | Compliant | All members of the Pensions Committee, Pension Investment Sub Committee and the Pension Administration Advisory Panel have equal access to committee papers, documents and advice that are due to be considered at meetings of the main committee. The Pensions Committee agendas and associated papers are published on the Council's website prior to the committee meeting. |
| **H** | **Scope** | | |
| a. | That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements. | Compliant | The Pension Administration Advisory Panel which meets twice yearly is also attended by the employer and employee representatives who sit on the Pensions Committee. This ensures flow of information between the wider scheme employers and the main committee. Scheme employers are invited to bring wider scheme issues to the attention of the Pensions Committee through the established communication routes. |
| **I** | **Publicity** | | |
| a. | That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in how the scheme is governed can say they want to be part of those arrangements. | Compliant | The Fund's Governance Policy Statement is published on the Council's website and all scheme employers are invited to attend the Pension Administration Advisory Panel meetings. The Fund ran an open recruitment process for the employer and employee representative appointments to the now established Pension Board.<br><br>Contact details are provided in the Communications Policy and in the Annual Report, as well as on the website, so other interested parties can find out more if they |

| Ref. | Principles | Compliance Status | Evidence of Compliance |
|---|---|---|---|
| | | | wish |

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worcestershire countycouncil

**AGENDA ITEM 14**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# PENSION FUND UNAUDITED ANNUAL REPORT AND ACCOUNTS 2018/19 PROPOSED DRAFT FORMAT

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**Recommendation**

1. **The Chief Financial Officer recommends that the Committee note and comment on the proposed extract of the draft format for the unaudited Pension Fund Annual Report and Accounts 2018/19 attached as an Appendix.**

**Background**

2. The annual report is a key communications channel between the fund and a wide variety of stakeholders. The report contains information relating to fund investments, administration, governance, valuations, accounts and membership

3. The attached proposed draft format for the Annual report 2018/19 is aimed to make the document more user-friendly and easier to read whilst ensuring compliance to statutory regulations. The extract provided excludes the statutory accounts part of the annual report as this will stay the same as the previous year updated for any legislative changes required.

4. The Committee's thoughts and comments on the proposed draft format are sought to further progress this document.

**Legislative Requirements and Guidance**

5. The requirement for and content requirements of LGPS pension fund annual reports in England and Wales was initially introduced under Regulation 34 of the LGPS (Administration) Regulations 2008. For reporting periods beginning 1 April 2014 and beyond, the statutory requirement in England and Wales can be found in Regulation 57 of The Local Government Pension Scheme Regulations 2013.

6. CIPFA published updated guidance in September 2014 that represents a general framework for pension fund administering authorities to meet their statutory obligation to prepare and publish an annual report for the pension fund. The Department for Communities and Local Government has adopted this guidance as statutory guidance for the purposes of regulation 57(3) in the 2013 Regulations.

7. The CIPFA guidance included the requirement for specific information to be published to assist the production of the scheme annual report compiled by the LGPS scheme advisory board.

## Contact Points

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Rob Wilson
Pensions, Investment, Treasury Management and capital strategy Manager
Tel: 01905 846908
Email: RWilson2@worcestershire.gov.uk

## Supporting Information

- Appendix – Draft Pension Fund Annual Report Extract 2018/19

## Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following background papers relate to the subject matter of this report.

2017/18 Pension Fund Annual Report and Accounts

worcestershire county council

Pension Fund

# DRAFT Annual Report and Financial Statements for the year ended 31 March 2019

# Worcestershire County Council Pension Fund

## Reports and Accounts for the year ended the 31st March 2019

## Table of Contents



## Important:

**This report should be read in conjunction with the following documents that are referred to within the report:**

- Full Listing of our Participating Employers.
- Investment Strategy Statement.
- Governance Policy Statement.
- Governance Compliance Statement.
- Funding Strategy Statement.
- Statement of Compliance with the UK Stewardship Code for Institutional Investors.
- Risk Register.
- Operational Plan for 2019.
- Policy Statement on Communication.
- Actuarial Valuation Report 2016.
- Worcestershire County Council Code of Conduct for Elected Members.

***Minutes of Pensions Committee and Pension Board meetings are also available on our website.***

# 1. Chair's Foreword

On behalf of the Pensions Committee, I am pleased to introduce an annual report which looks back on a scheme year of significant activity, continuing growth and considerable achievement of the Fund. The most notable achievements were:

- Our funding position being #% at 31 March 2019, in particular due to ### growth in assets.
- Management of risk through equity protection and starting our review of investment strategy and asset allocation review.
- Successful external audit of the 2017/18 Pension Fund Final Accounts
- Development and implementation of a Business Plan
- Reconciliation of the Fund's Guaranteed Minimum Pensions (GMPs).
- Being part of the establishment of a new investment pool, LGPS Central Limited on 1 April 2018 comprising 8 Funds.
- Increasing the number of our employers from ### to ###.
- Strengthening our management of and working with individual employers, for example by the introduction of employer covenant monitoring.
- Improved governance including the introduction of a training policy and delivery of an ongoing training programme for members of the Pensions Committee / Pension Board.
- Refreshing the content of our 'website'.

In the course of the year, the highlights of what was agreed by the Committee:
*###insert links to Cttee papers*

- A Pension Administration Strategy.
- Additional Pension fund investments to Walton Street US Property Fund II and Hermes Infrastructure Fund II
- Future transition of emerging market and corporate bond mandates to LGPS Central Limited in 2019.
- A Statement of Compliance with the UK Stewardship Code for Institutional Investors.
- Extra manpower and robust succession planning to support the Chief Financial Officer and to increase the Fund's engagement with its stakeholders.

During the year Fund membership continued to grow:

| | **31/03/2009** | **31/03/2014** | **31/03/2018** | **31/03/2019** |
|---|---|---|---|---|
| Employee Members | 20,282 | 20,739 | 22,478 | |
| Deferred members | 12,169 | 15,308 | 17,507 | |
| Pensioner members | 11,100 | 16,829 | 20,351 | |
| **Total Members** | **43,551** | **52,876** | **60,336** | |

As readers will be aware, the Fund primarily exists to pay pensions. This core activity of pension scheme administration was again delivered successfully throughout the year. From a Fund management perspective it is worth noting that the increase in pensioners since 2009 reflects the fact that people are living longer these days. This in turn means that the Fund needs to have more money available for longer to meet the 'guaranteed pension for life' promises made to its pensioners compared to what was needed in the past.

In the last year we had # new pensioners, split:

- # ill health.
- # early retirement.
- # normal age retirement.

The year saw # new employers joining and # employers exiting the Fund, bringing the total number of employers at 31 March 2019 to #. We anticipate that the total number of employers will continue to increase over the next few years due to further outsourcing of services and schools converting to academy status.

The year's key financials were that in a year that saw investment markets # *(insert a v short bit from investment adviser's report that is in the Investments section)*:

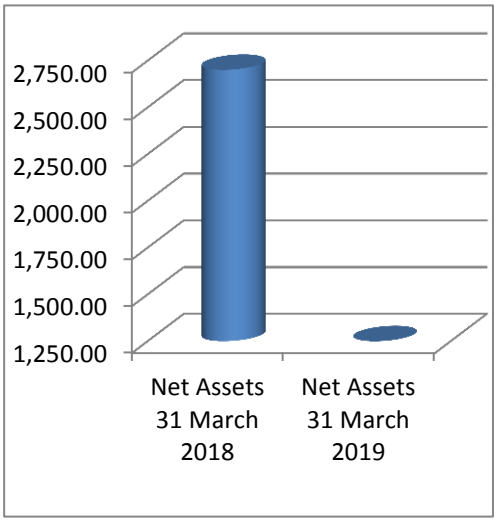
- The value of net assets increased to £# million at 31 March 2019 from £2,701.0 million at 31 March 2018.

- Income from contributions fell from £195 million to £# million) due mainly to some employers paying 3 years of pension contributions upfront in 2017 / 2018.

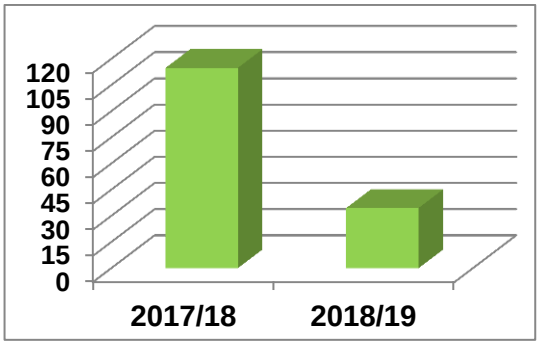
- Interim monitoring reports from our actuary show the funding level of ##% as at the 31st March 2019. In 2018-19 the fund had overall returns of #% against a universal average x%.

- A deficit of £# million resulted on the Fund Account compared to a surplus for 2017 / 2018 of £114.8 million mainly due to 3 years upfront contributions being paid in 2017 / 2018.

**Net Asset Value (£m)**




**Surplus on the Fund Account (£m)**



**Financial Summary**

| | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| **Contributions and Benefits** | | | | | |
| Contributions Receivable | 99.6 | 104.3 | 107.8 | 185.2 | |
| Individual Transfers | 4.1 | 5.4 | 8.0 | 10.4 | |
| | **103.7** | **109.7** | **115.8** | **195.6** | |
| Benefits Payable | -92.8 | -93.9 | -95.5 | -98.0 | |
| Payments to and on Account of Leavers | -57.3 | -7.3 | -7.0 | -8.8 | |
| | **-150.1** | **-101.2** | **-102.5** | **-106.8** | |
| Management and Admin expenses | -6.5 | -8.0 | -8.2 | -9.8 | |
| | **-52.9** | **0.5** | **5.1** | **79.0** | |
| **Return on Investments** | | | | | |
| Investment income | 40.8 | 38.1 | 29.4 | 35.8 | |
| Change in Market Value of Investments | 202.3 | -73.6 | 494.1 | 105.3 | |
| **Net Return on Investments** | 243.1 | -35.5 | 523.5 | 141.1 | |
| **Net Increase in the Fund** | **190.2** | **-35.0** | **528.6** | **220.1** | |
| **Net Assets at Year End** | **1,987.3** | **1,952.3** | **2,480.9** | **2,701.0** | |

Whilst this annual report by its nature looks back on 2018 / 2019, our Operational Plan for 2019 looks ahead, see: #

# three-year forecast of income and expenditure into and out of the fund (including administrative costs), in addition to an annual cashflow forecast, identifying performance against budget and highlighting and explaining any significant variances.

I'd like to finish my foreword by thanking all new and continuing members of the Committee, the Chair and members of the Pension Board, our advisers, staff at the Fund and our employers for all their continuing hard work for the Fund and its members.

Councillor B Banks
Chair
Worcestershire Pension Fund Pensions Committee

## 2. About the LGPS

The LGPS provides benefits for employees working in local government who are not teachers, police officers or fire fighters who have their own pension schemes. The LGPS is governed by the Superannuation Act 1972. The LGPS is granted “exempt approval” status by HM Revenue & Customs (HMRC) for the purposes of Income and Corporation Taxes Act 1988.

The LGPS is also classified as a Registered Pension Scheme under Part 4 of Chapter 2 of the Finance Act 2004 and the regulations are fixed on a national basis.

The current LGPS rules are contained within the LGPS Regulations 2013, the LGPS (Transitional Provisions, Savings and Amendment) Regulations 2014 and the LGPS (Amendment) Regulations 2015.

LGPS regulations specify the member contribution rates payable. Members currently pay a contribution rate of 5.5% to 12.5%, based on their actual pensionable pay.

Members have the freedom to opt out of the LGPS.

LGPS regulations specify the type and amounts of benefits payable.

## The Pensions Regulator (TPR)

Following the continuing expansion of its statutory duties in respect of Public Sector Pension Schemes that includes the LGPS, the TPR's priorities for 2018 to 2021 are:

- Enhancing and executing effective regulatory approaches across all schemes.
- Promoting good trusteeship through improving governance and administration.
- Effective regulation of defined benefit schemes.
- Effective regulation of master trusts.
- Ensuring employers meet their ongoing automatic enrolment duties.
- Preparing for the impact of Brexit.
- Equipping our staff to meet the challenges that TPR faces.
- Developing an approach to regulation that focuses on more proactive and targeted work and uses a wider range of regulatory interventions.

## LGPS benefits

Since April 2014 benefits are accrued on a Career Average Revalued Earnings (CARE) basis and include:

- An inflation protected pension at retirement, with the option to convert part of the pension to a tax free lump sum
- Early payment of benefits on ill-health

- Early payment of benefits if aged 55 or over if:
    - Made redundant
    - Retired through business efficiency
    - Taking flexible retirement
- A lump sum death grant on death in service
- An inflation protected dependent's pension if death occurs before retirement
- An inflation protected dependent's pension on death after retirement
- A lump sum death grant on death after retirement (depending on eligibility)
- The opportunity to transfer to another pension scheme provider
- A refund (depending on eligibility criteria but generally if scheme membership is less than 2 years)
- Purchase of extra pension by means of Additional Voluntary Contributions (AVCs) through the Fund's approved in-house AVC providers
- Purchase of additional pension through Additional Pension Contributions (APC's) arrangements

## About the Worcestershire Pension Fund

The LGPS is administered by 89 separate, designated Administering Authorities throughout England and Wales. Worcestershire County Council is the Administering Authority for the Local Government Pension Scheme (LGPS) within the Worcestershire and Herefordshire area.

Our primary objectives are to:

- Ensure that sufficient assets are available to meet our liabilities as they fall due.
- Maximise investment return at an acceptable level of risk.
- Enable employer contribution rates to be kept at a reasonable and affordable cost.
- Manage employers' liabilities effectively.
- Be a leading performer in the LGPS sector.
- Provide a high-quality pension service.
- Comply with regulations, legislation and codes of practice.
- Deliver the highest governance standards.

The Fund's membership profile as at 31 March 2019 was as follows:

| | % of members | | | |
|---|---|---|---|---|
| **Age Band (years)** | **Employee** | **Deferred** | **Pensioner** | **Total** |
| **<20** | | | | |
| **20 - 24** | | | | |
| **25 - 29** | | | | |
| **30 - 34** | | | | |

| | % of members | | | |
|---|---|---|---|---|
| **35 - 39** | | | | |
| **40 - 44** | | | | |
| **45 - 49** | | | | |
| **50 - 54** | | | | |
| **55 - 59** | | | | |
| **60 - 64** | | | | |
| **65 - 69** | | | | |
| **70 - 74** | | | | |
| **75 - 79** | | | | |
| **80 - 84** | | | | |
| **85 - 89** | | | | |
| **>90** | | | | |

The Fund has over 200 employers whose employees are members of the LGPS:

| | Active as at the 31/03/2019 | Ceased in 2018/19 | Total |
|---|---|---|---|
| Scheduled bodies | | | |
| Academies | | | |
| Designated bodies | | | |
| Admitted bodies | | | |
| **Total** | | | |

Notes:

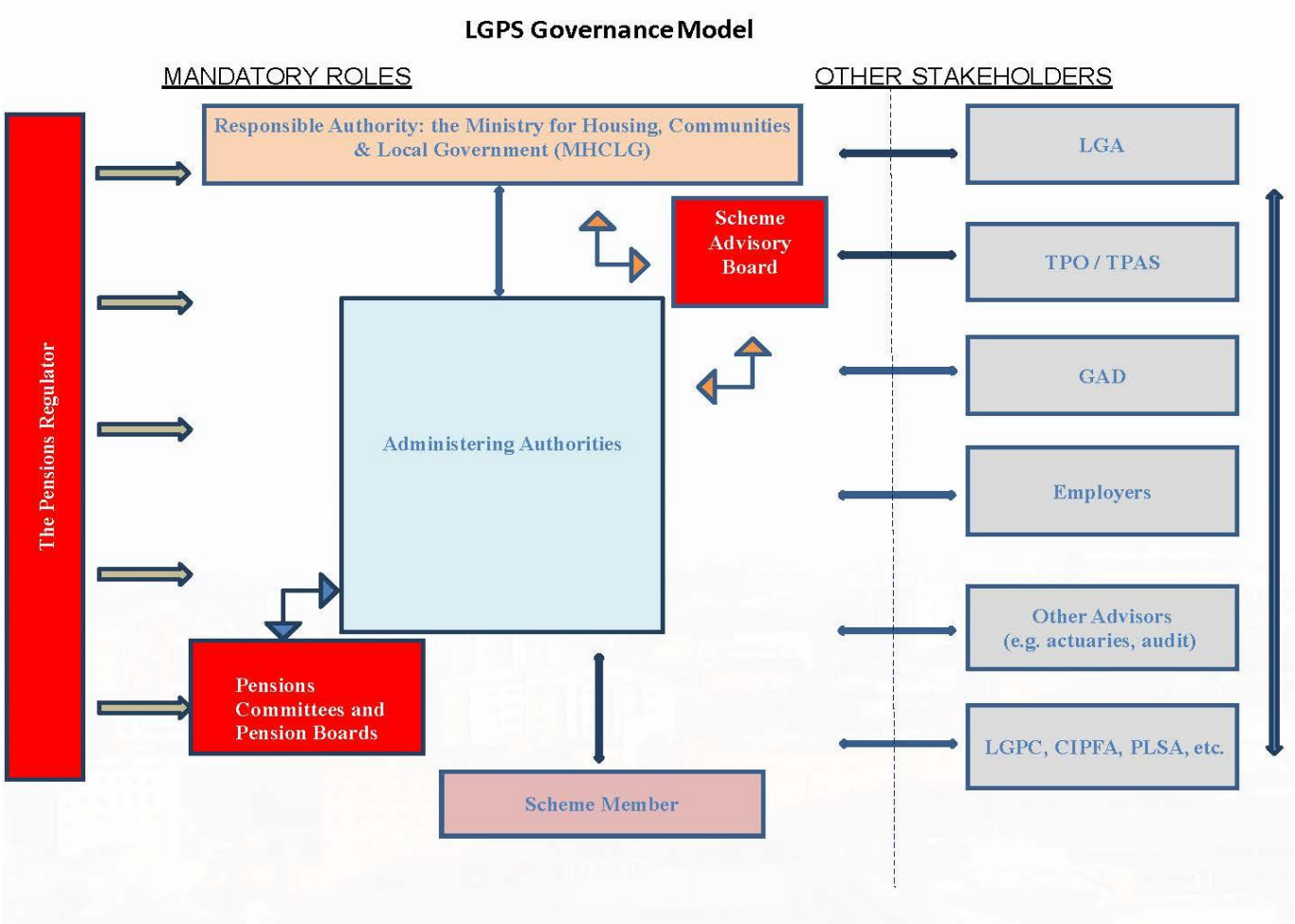
- Scheduled (in the regulations) bodies are organisations whose employees qualify to become members of the LGPS by right. These include county councils, district councils, foundation schools / colleges and academies (who are for presentation purposes shown as a separate category in the table above).
- Designated bodies are organisations that have passed resolutions with town or parish councils.
- Admitted bodies are organisations that fall into none of the previous 3 categories. Admitted bodies are voluntary / charitable bodies and other organisations to whom local government employees have been transferred under the outsourcing of local government services whose staff can, at the discretion of their employer, become members of the LGPS.

Note: A full list of our participating scheme employers is available at #.
# above table needs to include the amount of contributions received from each organization during the year split between employees and employers

# 3. Governance

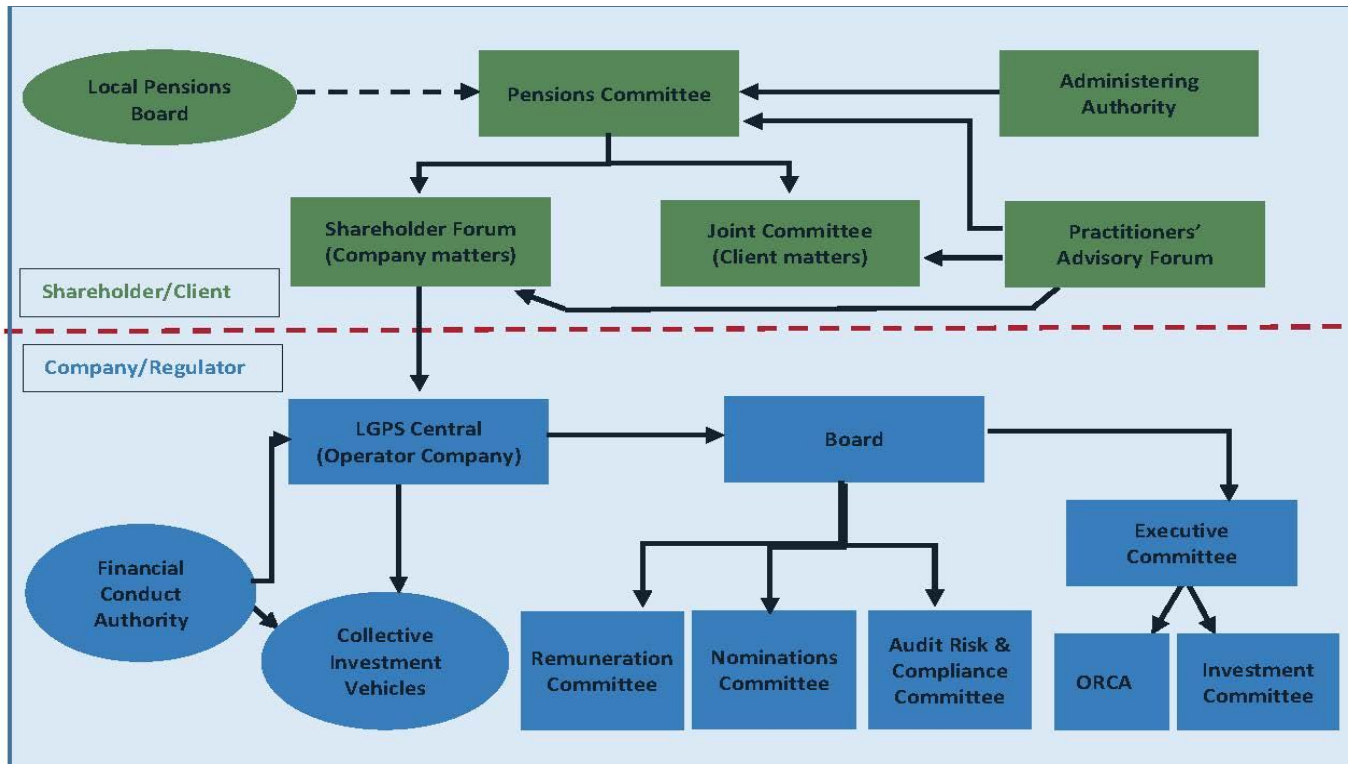
Our governance arrangements take account of:

- The way in which the LGPS is governed.
- The governance arrangements of LGPS Central Limited.
- The guidance issued by The Pensions Regulator.




## LGPS Central Limited

In collaboration with eight other Local Authorities (Cheshire, Leicestershire, Shropshire, Staffordshire, the West Midlands, Derbyshire, Nottinghamshire, and the West Midlands Integrated Transport Authority) we plan to pool actively managed assets using LGPS Central Limited using the following governance model.




## Worcestershire Pension Fund Governance

**Worcestershire County Council**

**Pensions Committee (section 101)**

**Key duties:**

To take all decisions needed:

- to discharge the Administering Authority's LGPS responsibilities
- for managing the Fund
- for administering the LGPS

**Pension Board**

**Key duties:**

To assist the Administering Authority in complying with LGPS regulations, other relevant legislation and any requirements imposed by The Pensions Regulator

To assist the Administering Authority in ensuring effective and efficient

**Pension Investment Sub Committee**

**Key duties:**

To develop investment strategy

To monitor investment performance

To assisting in the selection and appointment of investment managers

To set and review investment mandates and guidelines

**Pension Administration Advisory Forum**

**Key duties:**

To provide the Pensions Committee with advice concerning the administration of the Fund

To bring stakeholders' perspective to all aspects of the Fund's business

| | |
|---|---|
| **Administering Authority** | Worcestershire County Council<br>County Hall, Spetchley Road<br>Worcester WR5 2NP |
| **Scheme Manager** | Michael Hudson LLB (Hons), LLM,<br>CPFA Chief Financial Officer |

## Pensions Committee as at 31 March 2019

| | Meetings attended in 18/19 | | | | | Training received | |
|---|---|---|---|---|---|---|---|
| | 22/06 | 05/10 | 28/11 | 21/01 | 19/03 | 18/09 | 18/12 |
| Cllr B Banks (Chair) | ✓ | ✓ | ✓ | ✓ | | ✓ | |
| Cllr R Lunn | ✓ | | ✓ | ✓ | | ✓ | |
| Cllr P Middlebrough | ✓ | ✓ | | ✓ | | ✓ | ✓ |
| Cllr A Hardman | ✓ | | ✓ | | | ✓ | |
| Cllr P Tuthill | ✓ | ✓ | ✓ | ✓ | | | ✓ |
| Cllr R Phillips (Herefordshire) | | ✓ | | | | | ✓ |
| Adrian Becker – Unison (Employee Representative) | ✓ | ✓ | | ✓ | | ✓ | |
| Vic Allison (Employer Representative) | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ |

## Pension Board as at 31 March 2019

| | Meetings attended in 18/19 | | | | Training received | |
|---|---|---|---|---|---|---|
| | 02/05 | 25/7 | 31/10 | 04/02 | 18/09 | 18/12 |
| Keith Bray (Chair) | ✓ | ✓ | ✓ | ✓ | | |
| Lyn-Marie Chapman | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Kim Wright | | ✓ | ✓ | ✓ | ✓ | |
| Phil Grove | ✓ | | ✓ | ✓ | ✓ | |
| Nigel Shaw | ✓ | ✓ | ✓ | ✓ | | ✓ |

**Notes:**

(1) The training on 18 September covered the administration cycle, GMPs, covenant monitoring, asset allocation and investment pooling.

(2) The training on 18 December covered data quality, the administration cycle, equities and transitioning assets.

### Pension Investment Advisory Panel (2018 / 2019)

Councillor A I Hardman (Chair)
Councillor R W Banks
Councillor L Mallet
Mrs D Duggan – Unison
Mrs J Bennet – Unison
Michael Hudson LLB (Hons), LLM, CPFA Chief Financial Officer
Rob Wilson Pensions Investment, Treasury Management Manager

### LGPS Central Limited shareholder representative

Councillor A I Hardman

### Fund Investment Managers as at 31 March 2019

JP Morgan Asset Management
Legal & General Investment Management
Venn Partners
Invesco Real Estate
Walton Street Capital, LLC
Stonepeak Infrastructure partners
EQT
Nomura Asset Management UK Ltd
Schroder Investment Management
Hermes Investment Management
UK Green Investment Bank
First State Investments
AEW
River & Mercantile

### Global Custodian (2018 / 2019)

BNY Mellon

### Independent Investment Adviser (18 / 19)

M J Hudson

### Actuary to the Fund

Mercer Human Resource Consulting

### Environmental Social Governance (ESG) adviser

LGPS Central Limited

### Bankers

Barclays

### Auditors to the Fund

Grant Thornton UK LLP

### Legal adviser

Worcestershire County Council

### In house AVC provider

Scottish Widows

### Pension Administration Advisory Forum

The Fund invites all employers to these which are held at least twice a year.

Please refer to the following for full details on our governance arrangements:

- Our Governance Policy Statement
- Governance Compliance Statement 2019

## 4. Funding

Members' accrued benefits are guaranteed by statute. In line with government requirements we undertake actuarial valuations to compare the Fund's assets against its liabilities (its funding position) at a given point in time, assuming no further benefits are accrued after the valuation date.

At the last actuarial valuation (as at 31 March 2016) the Fund's assets of £1,952 million represented 75% of the Fund's past service liabilities of £2,606 million (the "Funding Target"). The deficit of £654 million was planned to be eliminated by a contribution addition of £34 million per annum increasing at 3.7% per annum for 18 years.

As at 31 March 2019 we estimate that the Fund was #% funded. The actual funding position as at 31 March 2019 will be confirmed by the actuarial valuation.

To meet the requirements of the regulations, we have set a clear long-term funding objective; to achieve and then maintain assets equal to 100% of projected accrued liabilities, assessed on an ongoing basis.

In tandem with the actuarial valuation the Actuary helps us to produce a Funding Strategy Statement that is available from our website. This focuses on the pace at which future benefits will be funded and on practical measures to ensure that employers pay for their own liabilities.

Members' contributions are set at a rate which covers only part of the cost of accruing benefits after the valuation date. Employers pay the balance of the cost of delivering future benefits to members.

At the 2016 actuarial valuation a common rate of contribution of 15.3% of pensionable pay per annum was set for employers.

As the Actuary assessed the particular circumstances of each employer, including the strength of its covenant, and its individual membership experience within the Fund, the Actuary applied individual adjustments to each employer to reflect these circumstances.

This resulted in a higher contribution rate than the baseline 15.3% and / or an annual cash contribution at a fixed amount being set for many employers.

The next actuarial valuation and review of the Funding Strategy Statement will be carried out as at 31st March 2019, with any changes to employers' contribution rates being implemented with effect from 1 April 2020.

The 2016 actuarial valuation report is available at #

Our Funding Strategy Statement is available at #

## 5. Investments

Subject to the LGPS regulations on allowable investments, the Fund may invest in a wide range of assets and strategies including quoted equity, government bonds, corporate bonds, money markets, traded options, financial futures / derivatives and alternative strategies including infrastructure / property pooled funds.

The Fund's investment objective is to support the funding strategy by adopting an investment strategy and structure which incorporate an appropriate balance between risk and return.

Our Investment Strategy Statement is available at: #

The Pensions Committee retains responsibility for the investment strategy of the scheme but has delegated oversight of its implementation to the Chief Financial Officer. The Committee regularly reviews the Fund's investment management arrangements. In broad terms, at 31 March 2019 the Fund's strategic allocation was to be invested 75% in equities, 10% in fixed income and 15% in property / alternatives.

The Fund's assets are managed day to day by the Fund's appointed specialist, external investment managers.

The Fund is a partner fund of the LGPS Central Limited pool. During 2018 / 2019 no assets were transitioned to LGPS Central, but costs were incurred by all the partner funds under a cost sharing agreement and our contribution was:

| | Direct £000s | Indirect £000s | Total £000s | Cumulative £000s |
|---|---|---|---|---|
| **Set up costs:** Recruitment Legal Procurement<br>Other support costs e.g. IT, accommodation<br>Share purchase/subscription costs*<br>Other working capital provided e.g. loans Staff costs**<br>Other costs | | | | |
| **TOTAL SET UP COSTS** | | | | |

**Custodial arrangements**

Custody of the Fund's assets is provided by the Global Custodian, BNY Mellon Asset Servicing.

In addition to the custodian's role in the safe-keeping of the Fund's total assets, the custodian also provides settlement and income collection services, the exercise of voting rights and the execution of corporate actions in conjunction with the investment managers. The appointment of a global custodian also secures an independent confirmation of the fund's assets and their value.

**Investment monitoring and performance**

The Pension Investment Advisory Panel monitors external managers' performance and makes investment manager and asset allocation recommendations for the Pensions Committee to approve.

The Fund does not automatically rebalance mandates in line with the long-term investment policy as set out in the Investment Strategy Statement, therefore portfolio weights may vary compared to their long-term strategic total Fund weight.

**The Fund's actual asset allocations, investment income, investment managers and investment managers, benchmarks as at 31 March 2019 are shown below:**

| **Net investment assets as at 31 March 2019** | **UK** | **Non-UK** | **Global** | **Total** |
|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** |
| Equities | | | | |
| Bonds | | | | |
| Pooled property investments | | | | |
| Pooled infrastructure investments | | | | |
| Cash and cash equivalents | | | | |
| Other | | | | |
| Total | | | | |

#commentary on asset allocation

| **Investment income accrued during the financial year to 31 March 2019** | **UK** | **Non-UK** | **Global** | **Total** |
|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** |
| Equities | | | | |
| Bonds | | | | |
| Pooled property income | | | | |
| Pooled infrastructure income | | | | |
| Cash and cash equivalents | | | | |
| Other | | | | |
| Total | | | | |

#commentary on investment income accrued

**Actual asset allocations against the Strategic Asset Allocation targets 2018/19**

| Shares Managed | Target % | Actual % | Investment Manager and Benchmark |
|---|---|---|---|
| **Equity Shares Managed Actively** | | | |
| Far East Developed | | | Nomura Asset Management - FTSE All World Asia Pacific Index + 1.5% |
| Emerging Markets | | | JP Morgan Asset Management & Schroder Investment Management – FTSE All World Emerging Market index +2.0% |
| **Total** | | | **Equity Shares Managed Actively** |
| **Equity Shares Managed Passively** | | | |
| Market Capitalisation Indices | | | |
| United Kingdom | | | Legal and General Asset Management - FTSE All Share Index |
| North America | | | Legal and General Asset Management - FTSE All World North America - Developed Series Index |
| Europe ex - UK | | | Legal and General Asset Management - FTSE All World Europe ex UK Index -Developed Series Index |
| **Equity Alternative Indices** | | | |
| Global | | | Legal and General Asset Management**: 40%** GPAE - FTSE-Research Affiliates Fundamental Index( RAFI) Dev 1000 Equity Fund, **30%** GPBK - MSCI World Mini Volatility Index, **30%** STAJ - CSUF - STAJ |
| **Total** | | | **Equity Shares Managed Passively** |
| | | | |
| **Total Equities** | | | |
| | | | |
| **Fixed Interest** | | | JP Morgan Asset Management – 100% Barclays Global Aggregate Corporate Bond Index – Hedged into GBP |
| **Property / Infrastructure** | | | Invesco Real Estate, VENN Partners, Walton Street Capital, Green Investment Bank, Hermes |
| **Overall Total** | | **100.0** | |

As the majority of the improvement in the Fund's assets since the 2016 valuation was attributable to the rally in equity markets over the period, in late February / early March 2018 the Fund implemented an equity protection strategy using a 'static' options hedge solution to:

- Manage the risk of markets falling
- Reduce the likelihood that further deficit contributions will be required at the 2019 valuation
- Seek to 'bank' some of the recent upside with a view to potentially reducing contributions at future valuations

The first equity protection strategy was in place for the whole of 2018 / 2019 and will end in July 2019. Officers and the Committee review whether changes to the strategy on an ongoing basis.

## Investment performance

Investment performance is measured quarterly by Portfolio Evaluation Ltd. Against a market background of # (market commentary from investment adviser's report) whole of Fund performance was #

For the year ended 31 March 2019 the Fund's return of #% beat# the Fund's benchmark return by #% and outperformed# the Peer Universe return by #%.

The target annual return identified by the 2016 actuarial valuation was #%
# 1, 3 and 5 year table as per table below:

| Asset category | Opening value | | Closing value | | Performance | | Passive Index* | Local target % |
|---|---|---|---|---|---|---|---|---|
| | | | | | Gross % | Net % | | |
| Bonds - active | | | | | | | | |
| Bonds - passive | | | | | | | | |
| Equities - active | | | | | | | | |
| Equities - passive | | | | | | | | |
| Pooled Investment vehicles - active | | | | | | | | |
| Pooled Investment vehicles - passive | | | | | | | | |
| Derivatives | | | | | | | | |
| Hedge funds | | | | | | | N/A | |
| Property - directly held | | | | | | | N/A | |
| Infrastructure | | | | | | | N/A | |
| Insurance policies | | | | | | | N/A | |
| Loans | | | | | | | N/A | |
| Cash | | | | | | | N/A | |
| **Total** | | | | | | | | |

Individual investment manager performance for the year to 31 March 2019 was #

| Investment Manager | 1 Year Actual Return % | 1 year Benchmark Return % | 3 Year Actual Return % p.a. | 3 Year Benchmark Return % p.a. |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

| Investment Manager | 1 Year Actual Return % | 1 year Benchmark Return % | 3 Year Actual Return % p.a. | 3 Year Benchmark Return % p.a. |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |

The Committee generally has an ad-valorem fee scale applied in respect of the investment management services it receives. This is generally accepted practice for passive tracking mandates and is easily understood. A performance related fee basis is sometimes set, however if it is believed to be in the overall financial interests of the Fund, particularly for active mandates where higher fees are paid for more consistent outperformance of market indices. The approach taken varies depending on the type of investment and the target being set.

The Fund is required to report in line with the CIPFA requirements under the Transparency Code and requires its investment managers to provide sufficient information to fulfil this requirement.

## Environmental, social and governance (ESG) considerations

The Fund has a fiduciary duty and expects its investment managers to take account of financially material social, environmental and ethical considerations in the selection, retention and realisation of investments as an integral part of their normal investment research and analysis process insofar as these matters are regarded as impacting on the current and future valuations of individual investments.

The Fund is committed to ensuring that the companies in which it invests have good corporate governance, adopt a responsible attitude toward the environment and adopt high ethical standards.

It manages this duty in large part through its appointed advisers Pensions & Investment Research Consultants Limited (PIRC) to provide a global proxy service using PIRC Shareholder Voting Guidelines that are approved by the Fund.

The Fund receives proxy research and voting recommendations for each company AGM and EGM holding the Fund has that can be voted.

###data on voting

The Fund is also a member of the Local Authorities Pension Fund Forum (LAPFF), to enable it to act collectively with other local authorities on corporate governance issues. The Forum currently has over 70 member funds representing assets of more than £200 billion. LAPFF's mission is to protect the long-term investment interests of beneficiaries by promoting the highest standards of corporate governance and corporate responsibility amongst investee companies.

The introduction of the Stewardship Code in July 2010 by the Financial Reporting Council strongly encouraged best practice in respect of investor engagement. The expectation is that institutional investors should publish a statement in respect of their adherence to the code. Compliance with the Code is currently on a voluntary basis. Our Statement of Compliance with the UK Code for Institutional Investors is available at #. All of our global equity managers comply fully with the code.

## 6. Administration

**Our performance**

We measure how we perform against our target turnarounds for our key processes:

| **Activity / Process 2018/19** | **Turnaround (working days)** | **Target** |
|---|---|---|
| Letter detailing transfer in quote | | 10 |
| Letter detailing transfer out quote | | 10 |
| Process and pay refund | | 10 |
| Letter notifying estimate of retirement benefits | | 15 |
| Letter notifying actual retirement benefits | | 15 |
| Process and pay lump sum retirement grant | | 23 |
| Letter acknowledging death of member | | 05 |
| Letter notifying amount of dependant's benefits | | 10 |
| Calculate and notify deferred benefits | | 30 |
| Joiners notification of date of joining | | 40 |

**###commentary incl something on accuracy and the CIPFA benchmarks**

**Our expenditure**

# A budget v outturn report on the administrative costs of the fund during the year, including investment management expenses.

# 2018 / 2019 commentary

| Process | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|---|---|
| **Investment Management Expenses** | | | | | |
| Total cost (£'000) | 5.3 | 6.7 | 7.1 | 8.9 | |
| Total membership (Nos) | 55,275 | 57,821 | 59,196 | 60,336 | |
| Cost per member (£) | 96 | 116 | 120 | 147 | |
| **Administration Costs** | | | | | |
| Total cost (£'000) | 1.1 | 1.2 | 1.0 | 0.8 | |
| Total membership (Nos) | 55,275 | 57,821 | 59,196 | 60,336 | |
| Cost per member (£) | 20 | 21 | 17 | 13 | |
| **Oversight and Governance Costs** | | | | | |
| Total cost (£'000) | 0.1 | 0.1 | 0.1 | 0.1 | |
| Total membership (Nos) | 55,275 | 57,821 | 59,196 | 60,336 | |
| Cost per member (£) | 1.8 | 1.7 | 1.7 | 1.6 | |
| **Total cost per member (£)** | 117.8 | 138.7 | 128.7 | 161.6 | |

The administration team comprises # members of staff (# FTE). The Fund therefore has a ratio of one full time equivalent member of the team for every # Fund members. #benchmark unit costs

**The year 2018 / 2019**

As usual, paying pensions, processing retirements, processing deaths, processing refunds, delivering our year end and issuing annual benefit statements were our major administration deliverables.

New employers, employer restructures and delivering training for Pensions Committee and Pension Board members also required significant resource.

The introduction of employer covenant monitoring was a notable achievement. This revealed ###

We deliver our service using:

- The Altair pensions administration system.
- Our website that we refreshed during the year and that saw an increase in page views from ### to ###.
- Dedicated resource for each member requirement.
- Employer fora and monthly employer newsletters.
- # a description of the other key areas of technology used.

# We have the following arrangements in place for ensuring the accuracy and confidentiality of personal data.

The major administration pieces of work / projects undertaken during the year were:

- A Guaranteed Minimum Pensions reconciliation exercise.
- Introducing a Pension Administration Strategy.
- Reporting to The Pensions Regulator (TPR) / Occupational Pension Schemes Survey.
- Producing a new standard Admission Agreement.
- Introducing a new Termination Policy.
- Delivering annual benefit statements foe employee and deferred members.
- Delivering pensioner P60s and payslips.
- Providing FRS information to employers.
- Delivering Pension Savings Statements.

# the implementation of any contribution increases

# any bonds or any other secured funding arrangements entered into.

# A commentary on how employer discretions have been exercised in the reporting period

During the year, there were # cases dealt with by the Appointed Person responsible for considering Stage 2 appeals against employer decisions. In # cases the employer's decision was upheld.

Our appeals procedure is detailed on our website at # http://www.worcestershire.gov.uk/info/20408/worcestershire_pension_fund/1958/unhappy

There were # new dispute cases raised during the year and their resolutions were #

Our Policy Statement on Communication is available from our website at #

## 7. Risk

The Fund maintains a risk register that is available at #

As at 31 March 2019 the Fund's most significant risks were:

- #
- cost cap of the LGPS and pressure on local government budgets following the local government settlement

The nature and extent of risks arising from Financial Instruments are detailed in note 16 of the Pension Fund Accounts.

#assurance provided by the work of Internal Audit

## 8. Financial statements

This Statement of Accounts presents the overall financial position of the Worcestershire Pension Fund for the year ended 31 March 2019.

It is produced in accordance with best accounting practice, as set out in the Chartered Institute of Public Finance and Accountancy (CIPFA) example accounts.

**Not attached as will largely be the same format as 2017.18 updated for any statutory changes**

worcestershire countycouncil

**AGENDA ITEM 15**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# FORWARD PLAN

---

## Recommendation

1. **The Chief Financial Officer recommends that the Committee comment on and approve the Forward Plan and that this be reviewed at each Committee**

2. The forward plan was presented to the last Committee meeting to highlight the key areas that are anticipated to be reported in the future. The Forward Plan was approved and was to be reviewed at each Committee meeting. This is attached as an Appendix and Committee are asked to comment and approve the plan.

3. The highlighted areas are changes to the plan that were provided at the last meeting.

## Supporting Information

Appendix – Forward Plan

## Contact Points

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Rob Wilson
Pensions Investment, Treasury Management & Capital strategy manager
Tel: 01905 846908
Email: RWilson2@worcestershire.gov.uk

## Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report:

This page is intentionally left blank

## Pensions Committee Proposed Forward Plan

**Appendix**

| Pension committee Items | 05/10/2018 | 28/11/2018 | 19/03/2019 | 21/06/2019 | 04/10/2019 | 06/12/2019 |
|---|---|---|---|---|---|---|
| LGPS Central Update | Y | Y | Y | Y | Y | Y |
| Pension investment Update | Y | Y | Y | Y | Y | Y |
| Pension Key Performance Indicators | | | ➡ | Y | Y | Y |
| Pension fund Unaudited Annual Report | | | Y | Y | | |
| Pensions Final External Audit Report on Annual Report | Y | | | | Y | |
| Pension fund administration Budget Approval | Y | | Y | | | |
| Pension fund administration Budget Monitoring | | | Y | | Y | |
| Government Actuary Dept (GAD) review update | Y | Y | | | | |
| Members Training update | | ➡ | Y | Y | | Y |
| Investment Strategy Statement update | | X | Y | | | |
| Administrative Authority update | Y | Y | Y | Y | Y | Y |
| Equity Protection update | | Y | Y | | | |
| Risk Register | Y | Y | Y | Y | Y | Y |
| Actuarial Valuation and Funding Strategy Statement | | | | | Y | Y |
| Business Plan | | | Y | | Y | |
| internal Audit Report | | | | Y | | Y |
| Local pension Board updates including such areas as Regulatory Scheme Advisory Board (SAB) updates | | | Y | Y | Y | Y |
| Stewardship Code Compliance Statement | | Y | | | | Y |
| Pensions Committee & Investment advisory Panel terms of Reference | | | Y | | | |
| Admin Strategy (Flows into Business Plan where actions are) | | ➡ | Y | | | |

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worcestershire countycouncil

**AGENDA ITEM 16**

# PENSIONS COMMITTEE
# 19 MARCH 2019

# PENSION INVESTMENT UPDATE

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**Recommendation**

1. **The Chief Financial Officer recommends that:**

   a) **The Independent Financial Adviser's fund performance summary and market background be noted (appendices 1 to 3);**

   b) **The update on the Investment Managers placed 'on watch' by the Pension Investment Advisory Panel be noted;**

   c) **The update on the Property and Infrastructure commitments be noted;**

   d) **He be authorised to revisit the specific US Property Debt Walton Street Fund II investment and consider currency hedging options at each capital drawdown of the investment, in consultation with the Chairman of the Pensions Committee and Chairman of the Pensions Investment Advisory Panel (Exempt Appendix 4);**

   e) **The outcome of the due diligence report for Venn Fund II be noted (Exempt Appendix 5);**

   f) **The transition of the existing active Emerging Market investments into the LGPS Central Global Emerging Markets Fund subject to appropriate due diligence being undertaken be agreed (Exempt Appendix 6);**

   g) **The potential transition of the existing Active Corporate Bond fund into the LGPS active be noted;**

   h) **The funding position compared to the investment performance be noted;**

   i) **The update on Responsible Investment activities and Stewardship investment pooling be noted; and**

   j) **The LGPS - Statutory guidance on asset pooling informal consultation and the proposed response from Worcestershire County Council Pension Fund be noted (Appendix 8).**

**Background**

2. The Committee will receive regular updates on Fund performance. The Fund's Independent Financial Adviser has provided a Fund performance summary and a brief market background update at Appendix 1 together with the following supporting information.

- Bar Chart of active investment managers' performance (Appendix 2)
- Portfolio Evaluation overall Fund Performance Report (Appendix 3)

The market background update is provided to add context to the relative performance and returns achieved by the Fund's investment managers.

3. The Committee will also receive regular updates regarding 'on watch' managers and will receive recommendations in relation to manager termination in the event of a loss of confidence in managers by the Pension Investment Advisory Panel (Appendix 1).

*JP Morgan Emerging Markets*

4. JP Morgan (Emerging Markets) portfolio underperformed against their benchmark over the quarter with an underperformance recorded of -1.6% against their benchmark (-5.4% v. -3.9%) over the quarter. The cumulative effect of three poor quarters has badly hit their performance against their benchmark over one year, now behind by -4.1% (-11.7% v. -7.6%).

5. This scale of underperformance has regrettably had a clear negative impact on their three year performance against target, now -2.0% annualised. Since inception they have slipped further behind target, at -1.5% against their performance requirement. Both country allocation and stock selection had a negative impact on performance in Q4.

*JP Morgan Corporate Bond*

6. JP Morgan reported an underperformance of -0.6% (-1.0% v -0.4%) in Q4 2018 against their benchmark. Their performance against benchmark over the last 12 months has deteriorated further, putting them into negative territory at -0.6% (-3.3% v -2.7%), which is obviously well behind their performance target. Relative to their performance target, they are behind by -0.8% over three years, and -0.7% over ten years, which has deteriorated.

7. It is recommended that JP Morgan Bonds and Emerging Markets remain on watch until their three year performance is tracking further towards target. However, it is likely that these funds will transition to mandates provided by LGPS Central which are explained further in this report.

## Property and Infrastructure Commitments

8. At the last meeting of the Committee the performance update provided details of the Property and Infrastructure commitments detailing some key issues for consideration, one of them being the maturity to real estate debt funds (Venn and Walton Street).

9. The Committee agreed to allocate £30m to Venn Fund II and a suitable commitment to Walton Street Fund II in the region of the current allocation of £27m subject to due diligence taking place.

*Walton Street Fund II*

10. The due diligence report for Walton Street undertaken by the LGPS Central Alternatives Investment Director was received on the 14 November 2018 and considered by the Chairman of the Committee, Chairman of the Pensions Investment Advisory Panel, the funds independent investment consultant and the Chief Financial Officer on the 28 November 2018. The recommendation within the report stated '*Taking all the areas discussed into account LGPS Central would recommend an investment into Walton Street Real Estate Debt Fund II*.'

11. The salient factors and risks were discussed in detail and an investment of $40m (equivalent to around £30m in sterling) was agreed subject to currency hedging options being explored to guard against the impact of the currency being the US dollar and the potential impact on returns.

*Currency Hedging*

12. The fund has traditionally not undertaken specific currency hedging facilities as they tend to be costly and over time have been fairly cost neutral. The Fund has benefitted from the weakness in GBP over the last couple of years as equity markets have risen. There was always going to be some element of "give back" at some stage which was one of the reasons for having the equity protection strategy in place. Currency issues have been and will continue to be carefully considered, even if we ultimately take no actual action.

13. LGPS Central were asked to explore potential Currency hedging options in relation to this particular investment (Executive summary at Appendix 4).

14. Given that USD/GBP is near historical lows, a volatile environment and the ongoing Brexit uncertainty, USD/GBP moves are possible in either direction, but in LGPSC's view it is more likely for GBP to appreciate than depreciate.

15. The report concluded that the:-

a) Biggest currency risk of the Investment in our assessment is GBP appreciating against USD;
b) Due to remaining Brexit uncertainty GBP is expected to remain volatile; and
c) The Fund can choose to "insure" (hedge) the risk, thereby stabilising the Investment return

16. This was debated at the Pensions Investment Advisory Panel (PIAP) on the 28 February 2019. It was agreed that although in general terms our basic principle is not to hedge our current investment exposure, it was felt that for this specific investment we will look to revisit and consider currency hedging options at each capital drawdown of the investment in liaison with the Chair of the Pensions Committee and Chair of the Pensions Investment Advisory Panel.

*Venn Fund II*

17. The due diligence report for Venn (attached as Appendix 5) undertaken by the LGPS Central Alternatives Investment Director was circulated to the Chair of the Pension Committee and Chair of PIAP on the 1 March for consideration. The recommendation within the report stated '*Taking all the areas discussed into account LGPS Central would recommend an investment into Venn Capital Debt Fund II*.'

18. This was agreed and the Finance Manager for Pensions was asked to negotiate the suggested changes to the Investment Rate of Return, Fees and staggered investment with Venn.

**Transition of Active Emerging Market Equities and Corporate Bonds to LGPS Central**

*Active Emerging Markets*

19. Pensions Committee have been kept up to date with the process being conducted for the transition across of our active Emerging Markets equities to the LGPS Central Active Global Emerging markets mandate (AGEM). Worcestershire currently has active emerging market mandate with JP Morgan and Schroder's totalling £331.2m as at the end of December 2018. The attached presentation (Appendix 6) details the rigorous process that was conducted to appoint 3 fund managers being the Bank of Montreal (BMO), Vontobel and UBS.

20. LGPS Central felt that the appointment of three managers was the most appropriate structure as it provided a good mix of cost savings. diversification of risk and investment returns.

21. At the Stakeholders day presided over by LGPS Central on the 27 February 2019 some members of the Pensions Committee were taken through the attached presentation and given the opportunity to question the 3 appointed fund managers. The investment performance provided at the meeting showed that 2 out of the 3 appointed fund managers had performed better over 5 years in comparison to our best performing fund, whilst the other was on a par. The savings on fees is likely to be in the region of 15 to 30bps.

22. This was discussed in detail at the Pensions Investment Advisory Panel on the 28 February and it was agreed to transition the existing active emerging markets equities fund to the LGPS Central AGEM subject to appropriate due diligence being undertaken by the Pensions investment manager and the Funds Investment consultant.

23. Pensions Committee are asked to agree to the transition of the existing active emerging market equities to the LGPS Central AGEM subject to this due diligence taking place. If there are no issues from the due diligence, then we will work closely with LGPS Central to ensure a smooth a transition as possible and regular updates will be provided to Committee.

*Corporate Bonds*

24. The potential next transition is likely to be the existing active corporate bonds mandate currently with JP Morgan with an existing value as at December 2018 of £139.1m. The mandate being proposed by LGPS Central is a 'Global active Investment Grade Corporate Bond Fund. A rigorous process similar to that of the AGEM above has been conducted to appoint 2 fund managers being Fidelity IL Pension Management and Neuberger Berman (Europe) Limited.

25. LGPS Central are to arrange a product information day in order that Committee members can understand more about the proposed investment and ask questions directly to the appointed fund managers.

26. This will be discussed at the next Pensions Investment Advisory panel on the 11 June and further recommendations together with the details of the proposed fund investment will be bought to the Pensions Committee on the 21 June 2019.

**Estimated Funding Levels**

27. The last actuarial valuation undertaken as at the 31 March 2016 showed that the fund was 75% funded with a £654m deficit at this point. Mercers have provided an estimated update on a 'like for like' basis (Table 2 below) using the same assumptions as at the last valuation. The report to the November Committee showed that the fund was estimated to be 99% funded with a deficit of £19m as at the end of August 2018.

28. However Committee were informed to be cautious, particularly around the asset valuations being subject to market fluctuations as we had already seen some market volatility in October which would decrease the funding level and increase the level of deficit. This continued through to December 2018 and reduced estimated funding levels to 92% with a deficit of £221m, with a recovery in January to 94% funded with a deficit of £182m.

***Table 2: Estimated Pension Fund Funding levels based on a like for like comparison to the 2016 actuarial valuation.***

| | Mar-16 | Mar-18 | Aug-18 | Oct-18 | Dec-18 | Jan-19 |
|---|---|---|---|---|---|---|
| Assets £'M | 1,952 | 2,701 | 2,823 | 2,708 | 2,650 | 2,699 |
| Liabilities £'M | 2,606 | 2,794 | 2,842 | 2,861 | 2,871 | 2,881 |
| **Surplus (-) / Deficit** | **654** | **93** | **19** | **153** | **221** | **182** |
| **Estimated Funding Level** | **75%** | **97%** | **99%** | **95%** | **92%** | **94%** |

**Triennial Valuation 2020/21 to 2022/23**

29. Initial discussions have commenced with the actuary on the next triennial valuation and very draft initial contributions have been discussed with the County and District councils. There is still a lot of areas to finalise, such as risk management, investment returns, data quality, covenant, public sector pay estimates, etc., before final contribution rates will be finalised. A further strategy meeting is taking place on the 5 March which will take on board the Equity Protection strategy.

*Equity Protection*

30. Further discussions were held with River and Mercantile (R&M) on Equity Protection options on the 28 February 2019 and at the moment no further action is required. R&M will bring future detailed option proposals to the next Investment Advisory Panel on the 11 June and recommendations bought to Pensions Committee on the 21 June 2019. The current strategy expires between the 15 August 2019 and October 2019.

.**Strategic Asset Allocation**

31. Table 3 below shows the existing asset allocations against the Strategic Asset Allocation targets. This highlights that our overall investment in equities is still high being over 83.2% (85% in September 2018) (including the equity protection) compared to the target of 75%. This is mainly due to the committed Property and Infrastructure investments not being fully drawn down at this stage. As the drawdowns occur then this will bring in the actual asset allocations within the target parameters set as part of the investment strategy.

**Table 3 Strategic Asset Allocation targets**

| Fund as at the 31st December 2018 | | | Strategic Asset Allocation targets | |
|---|---|---|---|---|
| Asset Class | Portfolio Weight | | Asset Class | Portfolio Weight |
| **Actively Managed Equities** | **26.6%** | | **Actively Managed Equities** | **20.0%** |
| Far East Developed | 14.0% | | Far East Developed | 10.0% |
| Emerging Markets | 12.6% | | Emerging Markets | 10.0% |
| **Passively Managed Equities – Market Capitalisation Indices** | **30.8%** | | **Passively Managed Equities – Market Capitalisation Indices** | **40.0%** |
| United Kingdom | 13.5% | | United Kingdom | 23.5% |
| North America | 10.9% | | North America | 9.0% |
| Europe ex UK | 6.4% | | Europe ex UK | 7.5% |
| **Passively Managed Equities – Alternative Indices** | **15.0%** | | **Passively Managed Equities – Alternative Indices** | **15.0%** |
| Global | | | Global | 15.0% |
| **Equity Protection** | **10.8%** | | | |
| **Fixed Interest** | **5.5%** | | **Fixed Interest** | **10.0%** |
| Actively Managed Bonds & Corporate Private Debt | 5.5% | | Actively Managed Bonds & Corporate Private Debt | 10.0% |
| **Actively managed Alternative Assets** | **11.3%** | | **Actively managed Alternative Assets** | **15.0%** |
| Property | 5.2% | | Property & Infrastructure | 15.0% |
| Infrastructure | 6.1% | | | |
| **TOTAL** | **100%** | | **TOTAL** | **100%** |

32. Earlier on this Committee's agenda was the initial Strategic Asset Allocation Review undertaken by Hymans Robertson LLP and the key findings will be considered alongside the detailed strategic allocation review to be conducted later in the year. This report provided a very good foundation for this review and highlights a number of key questions and considerations for Committee relating to areas such as the Structured equity and investment pooling

**Responsible Investment (RI) Activities**

33. The term' responsible investment' refers to the integration of financially material environmental, social and corporate governance ("ESG") factors into investment processes. It has relevance before and after the investment decision and it is a core part of our fiduciary duty. It is distinct from 'ethical investment' which is an approach in which moral persuasions of an organisation take primacy over its investment considerations

34. The Fund adopts a policy of risk monitoring and engagement with companies with sub-optimal governance of financially material Responsible Investment (RI) issues, in order to positively influence company behaviour and enhance shareholder value; influence that would be lost through a divestment approach. The Fund extends this

principle of “engagement for positive change” to the due diligence, appointment and monitoring of external fund managers.

35. A report was presented to Committee on the 28 November detailing the Pension funds approach to responsible investment and seeking approval to the Stewardship Compliance Statement. As part of this report it was agreed that the key areas of the Local Authority Pension Fund Forum (LAPFF) quarterly engagement report be included in the Committees future pensions investment updates

36. The Local Authority Pension Fund Forum (LAPFF) exists to promote the long-term investment interests of member funds and beneficiaries, and to maximise their influence as shareholders whilst promoting the highest standards of corporate governance and corporate responsibility at investee companies. Formed in 1990, LAPFF brings together a diverse range of 79 public sector pension funds and five pools in the UK with combined assets of over £230 billion.

37. Some key highlights from their quarterly engagement report (Oct to Dec 18) were:-

- LAPFF raises the stakes and calls for a shareholder resolution at Ryanair
- AGM attendance raises operational risk of joint ventures in relation to Samarco dam
- Affordability and climate risk strategy explored in meetings with construction firms and housebuilders
- Regulatory and other challenges of plastic waste and pollution addressed with consumer goods and packaging companies

38. Through LAPFF, the Fund engaged with 95 companies during the quarter on issues ranging from human capital management and Board composition to climate change reporting and sustainability. Most engagements concerned shareholders rights. Two engagements led to a change in process and eight engagements led to a moderate / small improvement. Most engagements were conducted by meetings with specialist staff or the company Chair. The issues are set out in the Quarterly Engagement Report which is attached at Appendix 7 and is also available on LAPFF’s website together with the previous quarterly engagement reports. : lapff qrtly-engagement-reports.

**Stewardship in Investment Pooling**

39. As part of LGPS Central we are actively exploring opportunities to enhance our stewardship activities. More information is on the LGPS website LGPSCentral - Responsible Investment. One of the principal benefits, achieved through scale and resources arising from pooling are the improved implementation of responsible investment and stewardship. Through its *Responsible Investment & Engagement Framework* and its Statement of Compliance with the UK Stewardship Code, LGPS Central is able to help implement the Fund’s own *Responsible Investment Framework*. LGPS Central issues Quarterly Stewardship Reports to demonstrate progress on matters of investment stewardship and can be found on the above link.

**LGPS - Statutory guidance on asset pooling informal consultation**

40. The Ministry of Housing, Communities and Local Government Minister (MHCLG) have issued new statutory guidance on LGPS asset pooling (Appendix 8). This will set out the requirements on administering authorities, replacing previous guidance, and builds on previous Ministerial communications and guidance on investment strategies.

41. Views have been invited on the attached draft guidance. This will be an informal consultation with interested parties only, including the Scheme Advisory Board (SAB), Pensions Committees, Local Pension Boards, the pool Joint Committees or equivalent, the Cross Pool Collaboration Group, the pool operating companies where owned by participating funds, CIPFA and ALATS. The consultation will remain open for 12 weeks and will close on 28 March.

42. LGPS Central Partner funds are sending in a combined response as well as individual partner fund responses. Our response is attached at Appendix 8 for comment by the Committee.

43. **Please note that Appendices 4, 5 and 6 contain exempt information (on salmon pages) and should members wish to discuss the information included in these Appendices they would need to consider passing the appropriate resolution and moving into exempt session.**

## Contact Points

County Council Contact Points
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Worcestershire Hub: 01905 765765

Specific Contact Points for this report
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Pensions Investment, Treasury Management & Capital strategy manager
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Email: RWilson2@worcestershire.gov.uk

## Supporting Information

- Independent Financial Adviser summary report (Appendix 1)
- Bar Chart of active investment managers' performance (Appendix 2)
- Portfolio Evaluation overall Fund Performance Report (Appendix 3)
- LGPS Currency Hedging Executive summary (Appendix 4) **(Exempt Information – Salmon pages)**
- Venn Due Diligence report (Appendix 5) **(Exempt Information – Salmon pages)**
- Active Global Equities Mandate presentation (Appendix 6) **(Exempt Information – Salmon pages)**
- LAPFF Quarterly Engagement Report October to December 2018 (Appendix 7)
- LGPS Statutory guidance on asset pooling informal consultation Worcestershire County Council Pension fund response (Appendix 8)

## Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

- Agenda papers and Minute of the Pensions Committee meeting held on 28 November 2018

REPORT PREPARED FOR

# Worcestershire County Council Pension Fund

February 2019

**Philip Hebson**
**MJ Hudson Allenbridge**

philip.hebson@mjhudson.com



We understand that your preference is for your advisers to issue investment advice in the first person. We recognise that this preference is a matter of style only and is not intended to alter the fact that investment advice will be given by MJ Hudson Investment Advisers Limited, an exempt person under FSMA as required by the Pensions Act. We further note that you have requested that our focus in these reports is on recent short term performance notwithstanding that the FCA Rules would generally require us to place less emphasis on past performance and provide performance numbers over the longer term.

## Independent Investment Adviser's report for the Pension Investment Advisory Panel meeting

## 28 February 2019

### Global overview

In my last review I mulled over the exuberance we had seen in world markets during the summer months of Q3, wondering if and when it would all end. A while ago I likened the market behaviour (and that of our managers) to a variety of fairground rides. In Q4 it was definitely a ride on the Big Dipper, but with an entrance at the top of the dip! As the ride has continued into 2019, things have calmed down (recovered) a bit, but I wouldn't undo the seat belt yet. This ride could be far from being over. Although in the short term market falls can be painful, they do at least provide opportunities to acquire assets at cheaper prices, to state the obvious. However they might get cheaper!

Markets wise, the party certainly stopped in the US. The list of reasons is quite long, and in many ways predictable. Apparently part of it is about a wall, but surely President Trump has studied some history (or maybe not) and realised that walls don't work. Whatever, it has caused some chaos, particularly within government. As predicted the Fed raised interest rates again, but has flagged that the pace of future increases may slow, as concerns about longer term economic prospects grow ever darker. Then we have trade talks, political issues rumbling on, and fears that the seemingly unstoppable IT/Media companies (the FAANGs*) might be fallible after all. What goes up eventually comes down (like walls).

* = Facebook, Amazon, Apple, Netflix and Google

Do I really have to write about Brexit again? I would love to think that next time I sit at the keyboard typing the review that it will be all over, bar the shouting. Well, I can but hope. In reality, this is an enormous distraction in the business world, particularly for those that have to consider the consequences of the various scenarios that exist. I am optimistic about the future for the UK economy, but we have to get over many hurdles first. As for politics, I'll leave that to others, but it is hardly surprising that voters are disenchanted. That isn't just in the UK, by the way.

At the risk of sounding like a stuck record, those comments about disenchanted electorates certainly applies in Europe. Personally I'm not keen on Yellow Vests, preferring orange ones (railway hi viz!). I don't think that President Macron is keen on them either, and he has good reason. I fear that the economic issues that have dogged Europe (I do blame the Euro) aren't going away quickly enough and that the demonstrations of discontent will become more widespread. The Brexit negotiations are as much to do with keeping the lid on their internal problems as they are on winding Mrs May up, and the rest of us Brits. Once we are out of it, they will have to focus on more pressing matters.

In market terms Japan had a grim time in Q4, with mixed economic data due to a series of natural disasters causing a slowdown in economic activity. There was little corporate news except for the completion of the Softbank IPO, and the former CEO of Nissan making national headlines as he was arrested on suspicion of misusing company assets. Corporate miscreance is an issue in Asia that will keep recurring until business culture changes, not that Western companies are completely immune to that.

Rather conversely it could be said that Emerging Markets had a relatively benign time in Q4, but as the chart below shows they had been suffering on a relative basis through much of 2018. China first, well they did have issues, as trade tensions continued with the US and their economy carried on slowing down. At the time of writing the clock is ticking on tariff/trade issues being resolved, but the Chinese are at least making pragmatic noises. Elsewhere Mexican equities fell to a three-year low over the quarter, as worries over the administration's populist approach to economic policy rattled the Mexican market. The fall in crude oil prices, continued to pressurise oil-producing countries like Russia. By contrast, Brazil posted strong equities gains with the election of the far-right candidate, Jair Bolsonaro, as he promised economic reforms to boost growth and reduce the deficit by privatising state-run companies and signing bilateral trade deals.

I don't usually provide pretty pictures, but this does provide some perspective on the year that was 2018.

Global Equity Markets Performance 2018


Source: Bloomberg. All in local currency. FTSE All-Share Index (Ticker: ASX Index) S&P 500 Index (Ticker: SPX Index) Nikkei 225 Index (Ticker: NKY Index) MSCI World Index (Ticker: MXWO Index) MSCI Emerging Markets (Ticker: MXEF Index)

## Summary and Market Background

The value of the Fund in the quarter fell to £2.63bn, a decrease of £195m compared to the end September value of £2.82bn. The Fund produced a return of -5.2% over the quarter, which gave an outperformance against the benchmark of 2.4%. This was mainly attributable to a positive contribution from the equity protection strategy as markets experienced some heavy falls in October and again in December. The positive performances from the infrastructure and property investments have also helped to reduce the overall volatility of total Fund performance during this period. Over a 12 month period the Fund also recorded a positive relative return against the benchmark of 1.1% (-3.8% v. -4.9%). The Fund has outperformed over the three and five year periods, and now also over ten years, details of which can be found in Portfolio Evaluation Limited's report.

As a reminder, particularly to the wider external readership of this report, the equity protection strategy mandate with River & Mercantile was *implemented to secure some protection to the funding level* against a relatively significant fall in equity values, as seen in the fourth quarter, up until after the next Triennial valuation in April 2019 (covering an 18 month period), after which the position will be reviewed. Alongside a review of the risks associated with the Fund's relatively high allocation to equities and how that can be mitigated in the future, consideration of a further switch to other asset classes will be included in the strategic asset allocation review.

In sterling terms, and in almost any other terms, it would be fair to say that world markets had a horrible fourth quarter in 2018, which with the exception of the US also caused all other main equity markets to record losses for the year as a whole. On the flip side, Bonds generally fared well, with the exception of Corporate High Yield ("Junk") Bonds, as there was a flight to relative safety and quality. The Fund's active managers all had a grim quarter, which probably isn't a surprise. Nomura (Pacific) was again the relative "best" of the active equity manager pack, with an underperformance of -1.0%. Schroders (Emerging Markets) had another difficult quarter, with an underperformance of -1.2%. JP Morgan (Emerging Markets) once again collected the wooden spoon with an underperformance of -1.6%. Sadly there isn't any good news from active bonds either; JP Morgan (Bonds) also struggled in the volatile markets, recording an underperformance of -0.6% against their benchmark. The alternative passive strategies outperformed the total passive benchmark by 1.3% (-9.5% v. -10.8%). The active equities group also outperformed passive equities by 2.1% (-8.7% v. -10.8%), as despite the relative underperformance of the active managers the market indices they represent fell less than those in the passive section of the Fund.

World markets slammed into reverse gear in the fourth quarter of 2018, the falls seen wiped out all the gains seen in the middle months of the year. Sterling value falls were

muted in comparison with the US$ and the Euro. Only the US (S&P 500) showed an increase over the year on a sterling adjusted basis, by 1.6%, but fell by -4.4% in US$ terms.
Over the quarter, using the sterling adjusted basis, the MSCI World Index fell by -11.4%. Japan experienced the biggest fall amongst developed markets, -12.2%, followed by the USA at -11.5%. Europe (ex UK) was down by -10.9%, with the UK faring slightly better at -10.3%. Asia (ex Japan) did relatively well amongst developed markets, down just -6.6%. “Top” of the leader board was Emerging Markets at -5.2%, but with the usual very mixed experience on a country by country basis, some helped by the significant fall in the oil price. Our managers clearly got caught out by that!

Bond markets as a whole had a generally positive quarter, again so long as you look on a sterling adjusted basis. There was a distinct “flight to quality”, as Government bonds outperformed Corporate debt, and within that “Junk” bonds (non investment grade) performed poorly.

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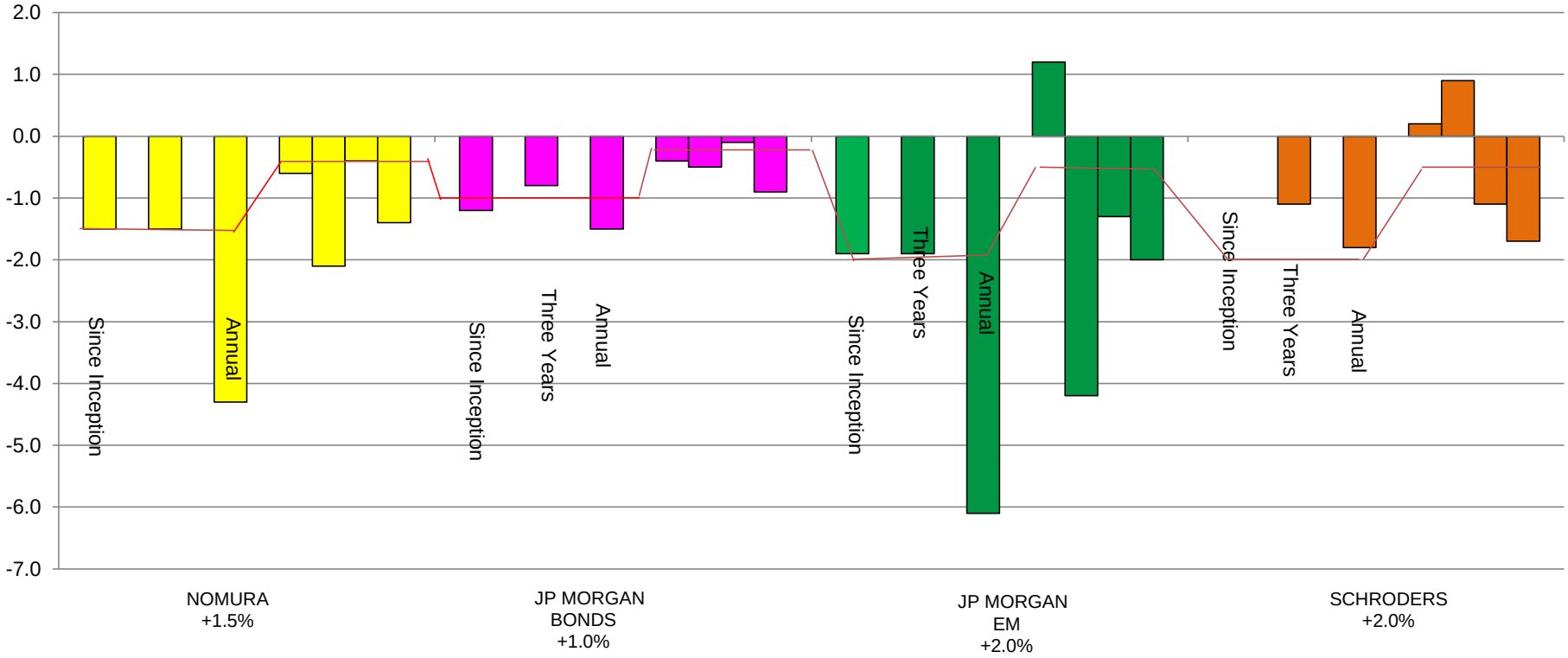
**Worcestershire County Council Pension Fund - Chart showing for each active manager: performance since inception, three years, annual performance Jan 2018 to Dec 2018 and latest year in quarter ends March 2018 to December 2018, relative to performance requirement**

0 = Performance Requirement (**PR**)



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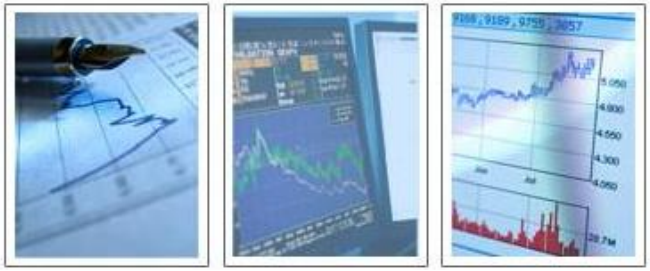
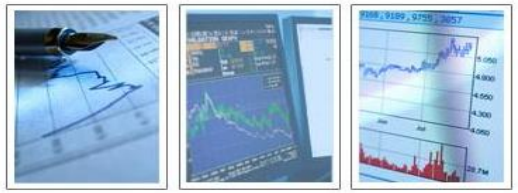


Specialists in Investment Risk and Return Evaluation

Quarterly Risk and Return Analysis
Total Fund

# Worcestershire County Council Pension Fund

Period ending 31st December 2018



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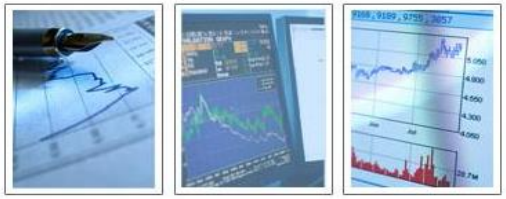
# Contents

**Worcestershire County Council Pension Fund Total Fund**



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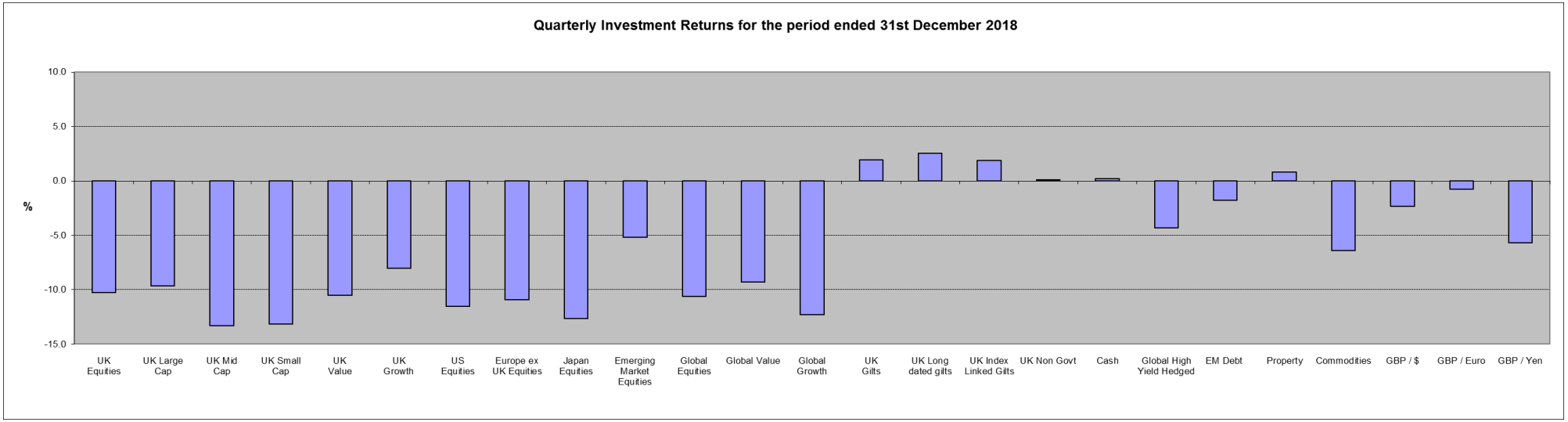
Specialists in Investment Risk and Return Evaluation

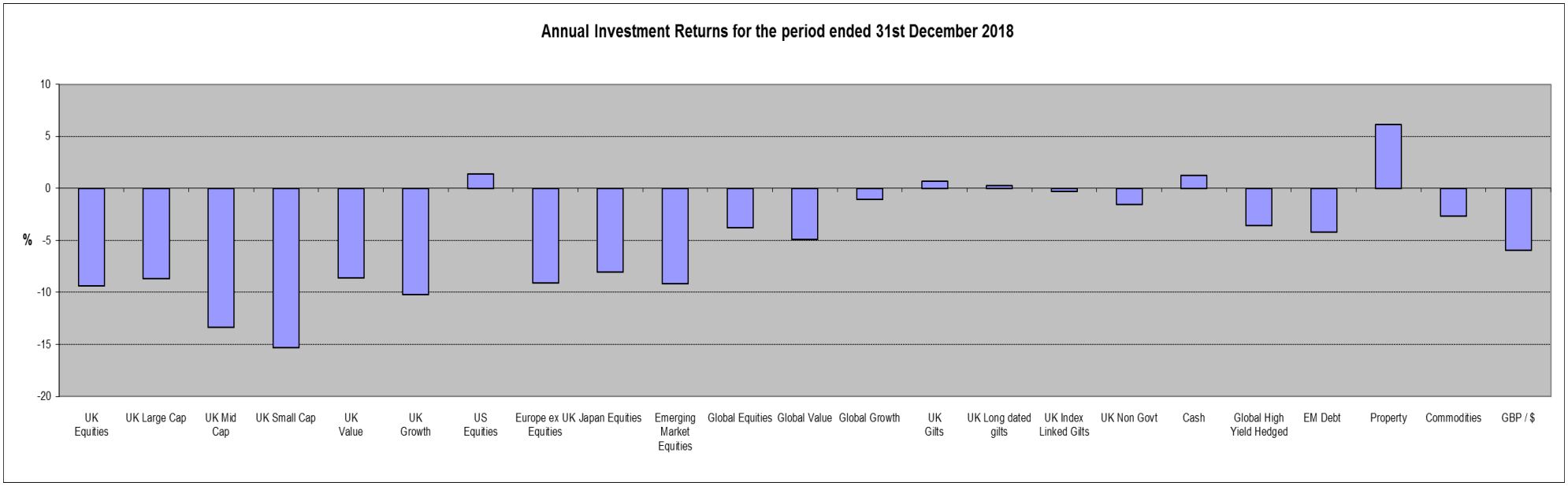
# Portfolio Evaluation Ltd Market Commentary Q4 2018 (Sterling)

Global equity markets had negative returns in Q4 2018 resulting in negative returns for all equity markets except for the US for sterling investors over the year of 2018. For a sterling investor this has resulted in all 'real return' asset classes, except US equities and UK property, having significant negative returns in 2018 (using an index based approach). In other asset groups such as corporate bonds, other than government nominal bonds and cash, returns were negative but to a lesser degree than equities. The reality of market returns in 2018 was somewhat different to the returns forecast by market commentators who were forecasting low but positive returns. The negative returns achieved in 2018 were probably primarily due to increased market uncertainty, a slowdown in global growth and increasingly fractious geopolitics; whilst market commentators expected global growth to slow in 2018 they probably did not expect it to be as notable or such issues as trade wars between the US and China plus the increasing political issues arising in Europe (such as Brexit and Italy). Of particular note has been the divergent growth of many economies; whilst the US continues to grow reasonably the growth rates in other regions have slowed markedly. Additionally economic growth has slowed significantly in China due to monetary policy tightening and the economy as domestic consumers become more important; this may bring problems for emerging markets and companies that are focussed on mineral and raw materials.





UK equities have fared particularly poorly due to reducing economic growth together with reduced investor sentiment due to the uncertainty caused by Brexit and the associated variable exchange rate. During the year cyclical sectors such as Consumer Goods and Technology have fared particularly poorly whilst more defensive / non-cyclical stocks have fared better especially in the fourth quarter. FTSE 100 stocks have been particularly volatile as they have been impacted by UK growth issues, lack of investment (negative impact) and by exchange rate volatility due to their overseas earnings (positive impact when sterling is falling and negative when the sterling is rising); however they have still outperformed smaller UK stocks. Market volatility has increased significantly in 2018 and is expected to continue into 2019.




Generally market commentators are expecting to see global growth slowing even more in 2019 although US growth will be higher than other regions. Corporate earnings growth is also expected to reduce; however market commentators are seeing the risk of a recessionary environment this year as low. There appears to be significant concerns about the outlook for the Eurozone and the outlook for the UK remains dependant on Brexit negotiations. Some commentators are seeing government bond yields as attractive as interest rates continue to increase. Overall market commentators seem to be cautious and focussing on 'quality' and multi asset class opportunities.

**For further information**

If you would like further information about the topics contained in this newsletter or would like to discuss your investment performance requirements please contact Nick Kent or Deborah Barlow Tel: +44 (0)1937 841434 (e-mail: nick.kent@portfolioevaluation.net) or visit our website at www.portfolioevaluation.net. Please note that all numbers, comments and ideas contained in this document are for information purposes only and as such are not investment advice in any form. Please remember that past performance is not a guide to future performance.

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# Worcestershire County Council Pension Fund - Commentary
# Period ending 31st Dec 2018

**QUARTERLY SUMMARY:** **Worcestershire County Council Pension Fund Return: -5.2% Benchmark Return: -7.6% Excess Return: 2.3%**

- Over the quarter there has been an investment into Invesco Real Estate UK Residential Fund

- The Fund achieved a total return of -5.2%. Infrastructure was the highest returning asset class at 2.2%, with property generating a return of 2.1%. Whilst Equity assets had a negative return of -6.3%. Fixed Income assets also had a negative return of -1.0%. Within equities, active equity returned -8.7%, alternatives generated -9.5% and passive equities generated -10.8% return. The equity protection strategy was a positive return generator at 28.5% which is reflective of negative performing equity markets and positive returning fixed income markets

- The Fund outperformed its benchmark by 2.3% this quarter. This was dominated by the equity protection portfolio managed by River and Mercantile; this accounted for 2.9% of the attribution to excess return but this is not unexpected given market movements in October and December, as well as the structure of the Fund (for example the bond collateral). The underweight UK equity position also generated significant excess asset allocation return. The active equity EMM portfolios and Nomura all dragged on the Total Equity and Total Fund excess returns. The JPM corporate bond portfolio also underperformed, whilst property and infrastructure outperformed their respective benchmarks. Within Infrastructure the Hermes II UK Infrastructure Fund generated the highest outperformance with a positive excess return of 3.5% compared to its respective benchmark

- All index funds tracked their benchmarks as expected

- The latest valuation data supplied by VENN, Walton Street, Green, EQT and Stonepeak was for period ending September 2018. While for the Invesco Real Estate UK Residential Fund we have been supplied only an inception contract note without any December valuation data

**YEAR SUMMARY AND LONGER:** **Worcestershire County Council Pension Fund Return: -3.8% Benchmark Return: -4.9% Excess Return: 1.1%**

- Over the year the Fund has generated a return of -3.8% outperforming the benchmark by 1.1%. Infrastructure and Property had positive returns 7% and 6.5% respectively, with both Equities and Fixed Income assets generating negative returns of -4.9% and -3.2%, although are both outperforming their respective benchmarks. It should be noted that within Infrastructure that all underlying funds have all underperformed their respective benchmarks except First State which outperformed by 4.6%

- Stock selection was the primary positive excess return contributor primarily due to the performance of the equity protection portfolio managed by River and Mercantile (this is not surprising given the underperforming equity returns), asset allocation over the year was also a positive contributor over the year due to being underweight within the negative returning UK equities and the exposure to the equity protection portfolio. Active equities have reduced the excess over the year with both Nomura and Emerging Markets – JPM both underperforming caused by negative stock selection

- Over the past three year period, this Fund has successfully outperformed for more observations than underperformed. This has occurred in both positive and negative markets. It is notable that whilst in positive markets the level of excess generated while out performing is similar to that generated when underperforming (+0.25% v -0.26%), when markets are negative the average excess return generated is higher (+0.48% v -0.38%)

- The Total Risk and Active risk are consistent with a typical multi asset class fund that uses both passive and active strategies

Client: Worcestershire County Council Pension Fund
Manager: Multi-manager
Mandate: Total Fund
Asset Class: Combined Assets
Benchmark: Worcestershire Total Fund Index
Inception: 31-Mar-1987
**Mkt Val: £2.6bn**

# Total Fund Overview
# Worcestershire CC Pension Fund
# Report Period: Quarter Ending December 2018

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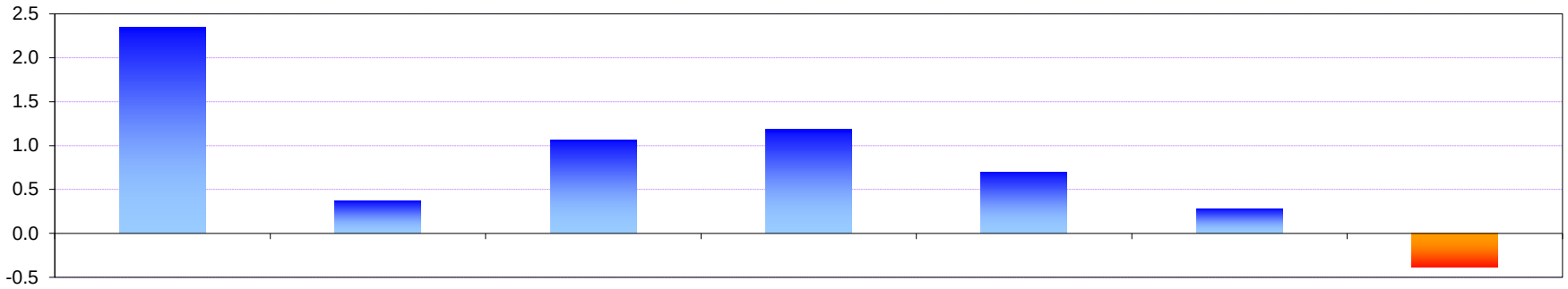
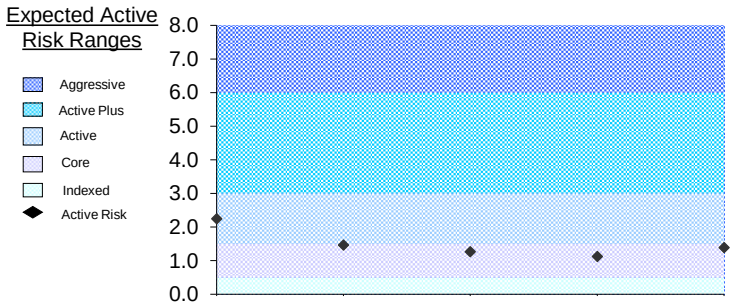
## Excess Return Analysis (%)




| | QTR | YTD | 1 Yr | 3 Yr | 5 Yr | 10Yr | Since Mar 87 (p.a.) |
|---|---|---|---|---|---|---|---|
| Excess Return | 2.3 | 0.4 | 1.1 | 1.2 | 0.7 | 0.3 | -0.4 |
| Portfolio Return | -5.2 | -0.4 | -3.8 | 10.6 | 8.1 | 9.8 | 7.9 |
| Benchmark Return | -7.6 | -0.8 | -4.9 | 9.4 | 7.4 | 9.5 | 8.3 |

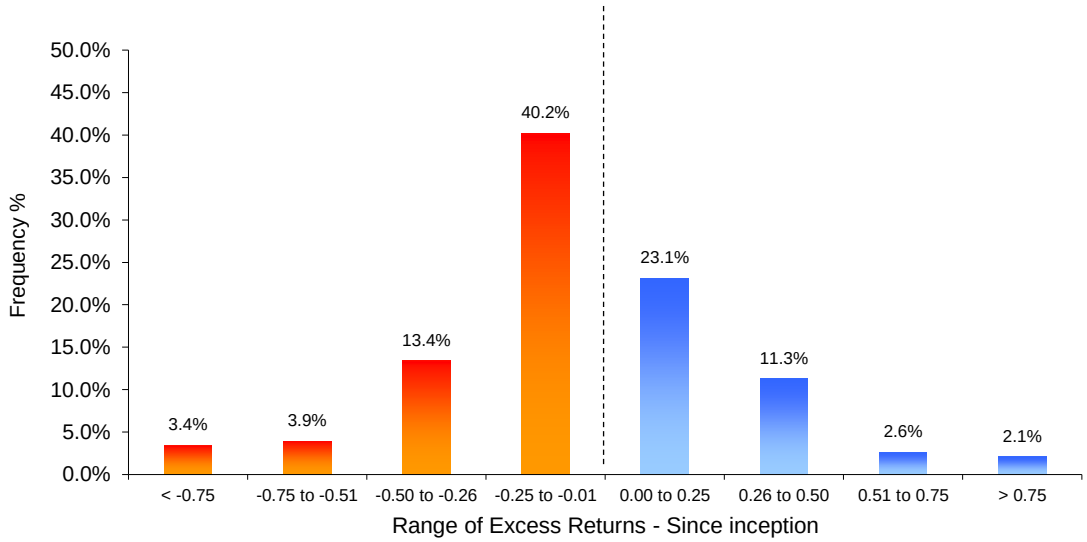
All returns for periods in excess of 1 year are annualised. The portfolio return is net.

## Ex-Post Active Risk Analysis (%)




| | 1 Yr | 3 Yr | 5 Yr | 10 Yr | Mar 87 |
|---|---|---|---|---|---|
| Active Risk | 2.3 | 1.5 | 1.3 | 1.1 | 1.4 |
| Portfolio Risk | 6.3 | 7.7 | 8.2 | 11.1 | 12.7 |
| Benchmark Risk | 7.9 | 8.0 | 8.2 | 10.9 | 12.5 |

## Excess Return Consistency Analysis




**Ex-Post Active Risk** measures the volatility of the actual excess returns achieved by the Portfolio/Fund.
**Excess Return Consistency Analysis** measures the frequency of the Portfolio/Fund's outperformance (Blue) and underperformance (Red) versus its benchmark, calculated using monthly (or quarterly if indicated) returns since inception.

# Attribution to Total Fund Excess Return Analysis
## Worcestershire County Council Pension Fund
## for Quarter Ended 31st December 2018

**Market Value: £2.6bn**

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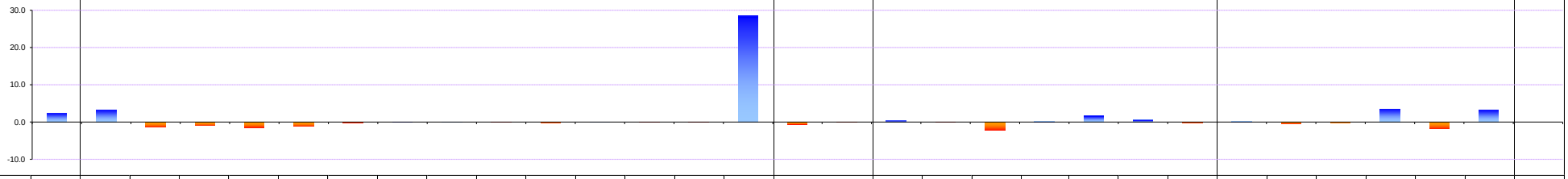
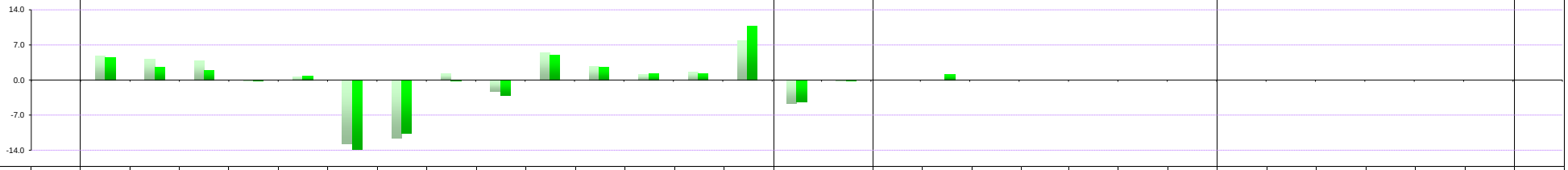
**Returns Summary (%)**




| | Total Fund | Total Equity | Total Active Equity | Far East Developed - Nomura | Emerging Markets - JPM | Emerging Markets - Schroder | Total Passive Equity | UK Equity - L&G | North American Equity - L&G | Europe ex UK Equity - L&G | Total Alternatives | FTSE RAFI DEV - L&G | MSCI World Min Vol TR - L&G | MSCI World Quality TR - L&G | River & Merc EQ Protection | Corporate Bond - JPM | EQT Mid-Market Credit II |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Excess Return | **2.3** | **3.2** | **-1.4** | -1.0 | -1.5 | -1.2 | **-0.2** | 0.1 | 0.0 | 0.0 | **-0.2** | 0.0 | 0.0 | 0.0 | **28.5** | **-0.6** | **-0.1** |
| Portfolio Return | **-5.2** | **-6.3** | **-8.7** | -11.5 | -5.4 | -5.1 | **-10.8** | -10.2 | -11.5 | -11.0 | **-9.5** | -10.9 | -5.5 | -11.6 | **28.5** | **-1.0** | **1.5** |
| Benchmark Return | **-7.6** | **-9.5** | **-7.2** | -10.5 | -3.9 | -3.9 | **-10.7** | -10.2 | -11.5 | -11.0 | **-9.3** | -10.9 | -5.5 | -11.6 | **0.0** | **-0.4** | **1.6** |

| | Total Property | Total UK Property | UK Property - Invesco | UK Property - VENN | US Property - Walton Street | Euro Property - Invesco | Property - AEW | Total Infra | UK Infra - Green | UK Infra Core - Hermes | UK Infra - Hermes II | Infra Core - Stonepeak | First State | Cash |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Excess Return | **0.4** | -0.1 | -2.2 | 0.1 | 1.6 | 0.5 | -0.2 | **0.1** | -0.4 | -0.3 | 3.5 | -1.9 | 3.2 | **0.0** |
| Portfolio Return | **2.1** | 2.1 | 0.0 | 2.3 | 3.2 | 2.1 | 1.4 | **2.2** | 1.4 | 1.7 | 5.6 | 1.0 | 5.4 | **0.0** |
| Benchmark Return | **1.7** | 2.2 | 2.2 | 2.2 | 1.6 | 1.6 | 1.6 | **2.0** | 1.8 | 2.0 | 2.1 | 2.9 | 2.2 | **0.0** |

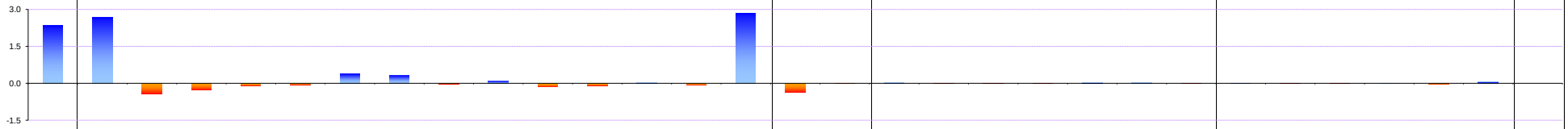
**Asset Allocation Summary (%)**




| | Total Fund | Total Equity | Total Active Equity | Far East Developed - Nomura | Emerging Markets - JPM | Emerging Markets - Schroder | Total Passive Equity | UK Equity - L&G | North American Equity - L&G | Europe ex UK Equity - L&G | Total Alternatives | FTSE RAFI DEV - L&G | MSCI World Min Vol TR - L&G | MSCI World Quality TR - L&G | River & Merc EQ Protection | Corporate Bond - JPM | EQT Mid-Market Credit II |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Portfolio Start | **100.0** | **85.9** | **28.2** | 15.8 | 5.8 | 6.6 | **34.4** | 15.0 | 12.2 | 7.2 | **15.4** | 6.1 | 4.5 | 4.9 | **7.8** | **5.0** | **0.2** |
| Portfolio End | **100.0** | **83.2** | **26.6** | 14.0 | 5.9 | 6.7 | **30.8** | 13.5 | 10.9 | 6.4 | **15.0** | 5.8 | 4.5 | 4.7 | **10.8** | **5.3** | **0.2** |
| Benchmark Start | **100.0** | **81.0** | **24.0** | 12.0 | 6.0 | 6.0 | **47.0** | 26.5 | 11.0 | 9.5 | **10.0** | 3.3 | 3.3 | 3.3 | **0.0** | **9.6** | **0.4** |
| Benchmark End | **100.0** | **78.7** | **24.0** | 12.0 | 6.0 | 6.0 | **44.7** | 24.2 | 11.0 | 9.5 | **10.0** | 3.3 | 3.3 | 3.3 | **0.0** | **9.6** | **0.4** |

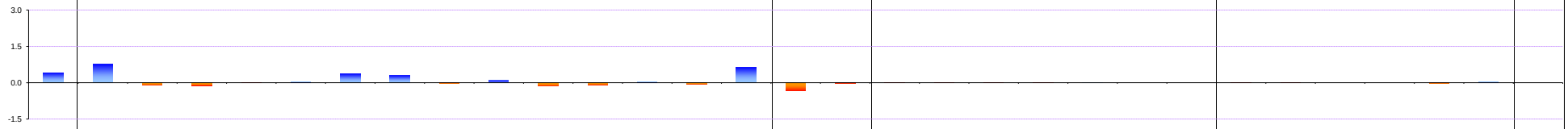
| | Total Property | Total UK Property | UK Property - Invesco | UK Property - VENN | US Property - Walton Street | Euro Property - Invesco | Property - AEW | Total Infra | UK Infra - Green | UK Infra Core - Hermes | UK Infra - Hermes II | Infra Core - Stonepeak | First State | Cash |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Portfolio Start | **4.7** | 0.0 | 0.0 | 1.0 | 0.5 | 2.5 | 0.7 | **4.2** | 1.8 | 1.4 | 0.2 | 0.3 | 0.6 | **0.0** |
| Portfolio End | **5.2** | 1.1 | 0.1 | 1.0 | 0.6 | 2.8 | 0.8 | **6.1** | 1.9 | 1.6 | 0.3 | 0.3 | 2.0 | **0.0** |
| Benchmark Start | **4.7** | 0.0 | 0.0 | 1.0 | 0.5 | 2.5 | 0.7 | **4.2** | 1.8 | 1.4 | 0.2 | 0.3 | 0.6 | **0.0** |
| Benchmark End | **5.2** | 0.0 | 0.1 | 1.0 | 0.6 | 2.8 | 0.8 | **6.1** | 1.9 | 1.6 | 0.3 | 0.3 | 2.0 | **0.0** |

**Attribution to Excess Return (%)**



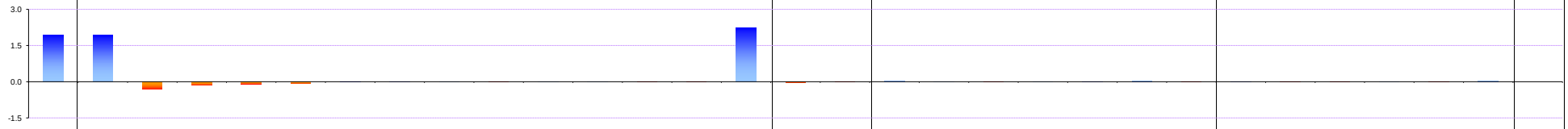

| | Total Fund | Total Equity | Total Active Equity | Far East Developed - Nomura | Emerging Markets - JPM | Emerging Markets - Schroder | Total Passive Equity | UK Equity - L&G | North American Equity - L&G | Europe ex UK Equity - L&G | Total Alternatives | FTSE RAFI DEV - L&G | MSCI World Min Vol TR - L&G | MSCI World Quality TR - L&G | River & Merc EQ Protection | Corporate Bond - JPM | EQT Mid-Market Credit II |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Excess Return | **2.3** | **2.7** | **-0.4** | -0.3 | -0.1 | -0.1 | **0.4** | 0.3 | 0.0 | 0.1 | **-0.1** | -0.1 | 0.0 | -0.1 | **2.9** | **-0.4** | **0.0** |

| | Total Property | Total UK Property | UK Property - Invesco | UK Property - VENN | US Property - Walton Street | Euro Property - Invesco | Property - AEW | Total Infra | UK Infra - Green | UK Infra Core - Hermes | UK Infra - Hermes II | Infra Core - Stonepeak | First State | Cash |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Excess Return | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** |




| | Total Fund | Total Equity | Total Active Equity | Far East Developed - Nomura | Emerging Markets - JPM | Emerging Markets - Schroder | Total Passive Equity | UK Equity - L&G | North American Equity - L&G | Europe ex UK Equity - L&G | Total Alternatives | FTSE RAFI DEV - L&G | MSCI World Min Vol TR - L&G | MSCI World Quality TR - L&G | River & Merc EQ Protection | Corporate Bond - JPM | EQT Mid-Market Credit II |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Asset Allocation | **0.4** | **0.8** | **-0.1** | -0.1 | 0.0 | 0.0 | **0.4** | 0.3 | 0.0 | 0.1 | **-0.1** | -0.1 | 0.0 | -0.1 | **0.6** | **-0.3** | **0.0** |

| | Total Property | Total UK Property | UK Property - Invesco | UK Property - VENN | US Property - Walton Street | Euro Property - Invesco | Property - AEW | Total Infra | UK Infra - Green | UK Infra Core - Hermes | UK Infra - Hermes II | Infra Core - Stonepeak | First State | Cash |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Asset Allocation | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** |




| | Total Fund | Total Equity | Total Active Equity | Far East Developed - Nomura | Emerging Markets - JPM | Emerging Markets - Schroder | Total Passive Equity | UK Equity - L&G | North American Equity - L&G | Europe ex UK Equity - L&G | Total Alternatives | FTSE RAFI DEV - L&G | MSCI World Min Vol TR - L&G | MSCI World Quality TR - L&G | River & Merc EQ Protection | Corporate Bond - JPM | EQT Mid-Market Credit II |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Stock Selection | **1.9** | **1.9** | **-0.3** | -0.1 | -0.1 | -0.1 | **0.0** | 0.0 | 0.0 | 0.0 | **0.0** | 0.0 | 0.0 | 0.0 | **2.2** | **0.0** | **0.0** |

| | Total Property | Total UK Property | UK Property - Invesco | UK Property - VENN | US Property - Walton Street | Euro Property - Invesco | Property - AEW | Total Infra | UK Infra - Green | UK Infra Core - Hermes | UK Infra - Hermes II | Infra Core - Stonepeak | First State | Cash |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Stock Selection | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** |

The **Returns Summary** details the Portfolio, Benchmark and Excess Returns. The Excess Returns are plotted. the **Asset Allocation Summary** details the weights held by the portfolio and benchmark in each asset class/manager. The green plots are the over/underweight exposures of the Fund (v Fund benchmark) at the beginning and end of the period. The **Attribution to Excess Return**, identifies how each asset class/manager has contributed to the overall excess return of the Total Fund. It is broken down into **Asset Allocation** (how successful the decision to over/underweight each asset class was) and then into **Stock Selection** (how well each manager/s decisions have performed). The **Asset Allocation** plus the **Stock Selection** excess returns are all additive and equal the **Total Excess Return** of the Fund.

# Attribution to Total Fund Excess Return Analysis
## Worcestershire County Council Pension Fund
## for Year Ended 31st December 2018

**Market Value: £2.6bn**

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| | Total Fund | Total Equity | *Total Active Equity* | Far East Developed - Nomura | Emerging Markets - JPM | Emerging Markets - Schroder | *Total Passive Equity* | UK Equity - L&G | North American Equity - L&G | Europe ex UK Equity - L&G | *Total Alternatives* | FTSE RAFI DEV - L&G | MSCI World Min Vol TR - L&G | MSCI World Quality TR - L&G | *River & Merc EQ Protection* | Corporate Bond - JPM | EQT Mid-Market Credit II | Total Property | *Total UK Property* | UK Property - Invesco | UK Property - VENN | US Property - Walton Street | Euro Property - Invesco | Property - AEW | Total Infra | UK Infra - Green | UK Infra Core - Hermes | UK Infra - Hermes II | Infra Core - Stonepeak | First State | Cash |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Returns Summary (%)** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Excess Return | **1.1** | **1.6** | **-2.4** | -2.7 | -4.1 | 0.2 | **0.6** | 0.1 | 0.1 | 0.0 | **-0.5** | 0.1 | 0.0 | 0.0 | **22.7** | **-0.6** | **3.7** | **-0.5** | -0.1 | -2.2 | -1.9 | 1.9 | -0.4 | -1.2 | **-1.2** | -1.8 | -4.0 | -2.6 | -27.9 | 4.6 | **0.0** |
| Portfolio Return | **-3.8** | **-4.9** | **-10.1** | -10.8 | -11.7 | -7.4 | **-6.4** | -9.3 | 0.9 | -9.1 | **-1.8** | -5.9 | 1.4 | 0.8 | **22.7** | **-3.2** | **8.0** | **6.5** | 2.1 | 0.0 | 7.1 | 8.4 | 6.1 | 7.0 | **7.0** | 5.8 | 4.4 | 2.2 | -15.9 | 9.8 | **0.0** |
| Benchmark Return | **-4.9** | **-6.5** | **-7.7** | -8.0 | -7.6 | -7.6 | **-7.0** | -9.5 | 0.8 | -9.1 | **-1.3** | -6.0 | 1.4 | 0.8 | **0.0** | **-2.7** | **4.3** | **7.0** | 2.2 | 2.2 | 9.0 | 6.5 | 6.5 | 8.2 | **8.2** | 7.6 | 8.4 | 4.9 | 12.0 | 5.2 | **0.0** |
| **Asset Allocation Summary (%)** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Portfolio Start | **100.0** | **87.2** | **29.0** | 15.9 | 6.3 | 6.8 | **43.6** | 25.4 | 11.0 | 7.2 | **14.6** | 5.9 | 4.3 | 4.4 | **0.0** | **5.1** | **0.0** | **4.2** | 0.8 | 0.0 | 0.8 | 0.4 | 2.5 | 0.4 | **3.5** | 1.8 | 1.7 | 0.0 | 0.0 | 0.0 | **0.0** |
| Portfolio End | **100.0** | **83.2** | **26.6** | 14.0 | 5.9 | 6.7 | **30.8** | 13.5 | 10.9 | 6.4 | **15.0** | 5.8 | 4.5 | 4.7 | **10.8** | **5.3** | **0.2** | **5.2** | 1.1 | 0.1 | 1.0 | 0.6 | 2.8 | 0.8 | **6.1** | 1.9 | 1.6 | 0.3 | 0.3 | 2.0 | **0.0** |
| Benchmark Start | **100.0** | **82.3** | **24.0** | 12.0 | 6.0 | 6.0 | **48.3** | 27.8 | 11.0 | 9.5 | **10.0** | 3.3 | 3.3 | 3.3 | **0.0** | **10.0** | **0.0** | **4.2** | 0.8 | 0.0 | 0.8 | 0.4 | 2.5 | 0.4 | **3.5** | 1.8 | 1.7 | 0.0 | 0.0 | 0.0 | **0.0** |
| Benchmark End | **100.0** | **78.7** | **24.0** | 12.0 | 6.0 | 6.0 | **44.7** | 24.2 | 11.0 | 9.5 | **10.0** | 3.3 | 3.3 | 3.3 | **0.0** | **9.6** | **0.4** | **5.2** | 0.0 | 0.1 | 1.0 | 0.6 | 2.8 | 0.8 | **6.1** | 1.9 | 1.6 | 0.3 | 0.3 | 2.0 | **0.0** |
| **Attribution to Excess Return (%)** | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Excess Return | **1.1** | **1.3** | **-0.9** | -0.5 | -0.3 | 0.0 | **0.3** | 0.2 | 0.0 | 0.1 | **0.1** | 0.0 | 0.1 | 0.1 | **1.7** | **-0.1** | **0.0** | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **-0.1** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** |
| Asset Allocation | **0.2** | **0.3** | **-0.2** | -0.1 | 0.0 | 0.0 | **0.3** | 0.2 | 0.0 | 0.1 | **0.1** | 0.0 | 0.1 | 0.1 | **0.2** | **-0.1** | **0.0** | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** |
| Stock Selection | **0.9** | **1.0** | **-0.6** | -0.4 | -0.3 | 0.0 | **0.0** | 0.0 | 0.0 | 0.0 | **0.0** | 0.0 | 0.0 | 0.0 | **1.6** | **0.0** | **0.0** | **0.0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **-0.1** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | **0.0** |

# Manager Return Analysis
## Worcestershire County Council Pension Fund
## for Period Ended 31st December 2018

PORTFOLIO EVALUATION LIMITED

**Market Value: £2.6bn**

| | Benchmark | Incep Date | Market Value (£m) | Weight | QTR | | | Year To Date | | | 1 Year | | | 3 Year | | | 5 Year | | | 10 Year | | | Since Inception | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | PF | BM | ER | PF | BM | ER | PF | BM | ER | PF | BM | ER | PF | BM | ER | PF | BM | ER | PF | BM | ER |
| **Total Equity Fund** | **Client Specific Weighted Index** | **Mar-16** | **2,184.0** | **83.2** | **-6.3** | **-9.5** | **3.2** | **-0.9** | **-1.6** | **0.7** | **-4.9** | **-6.5** | **1.6** | | | | | | | | | | **11.8** | **10.5** | **1.4** |
| *Total Active Equity Fund* | Client Specific Weighted Index | Mar-16 | 697.9 | 26.6 | -8.7 | -7.2 | -1.4 | -7.5 | -4.8 | -2.7 | -10.1 | -7.7 | -2.4 | | | | | | | | | | 13.3 | 12.4 | 1.0 |
| Far East Developed Fund - Nomura | FTSE Developed Asia Pacific Index | Feb-03 | 366.7 | 14.0 | -11.5 | -10.5 | -1.0 | -6.8 | -4.1 | -2.7 | -10.8 | -8.0 | -2.7 | 10.6 | 10.6 | 0.1 | 9.3 | 8.6 | 0.7 | 9.6 | 9.4 | 0.2 | 10.0 | 10.0 | 0.0 |
| Emerging Markets Fund - JPM | FTSE All World Emerging Market Index | Dec-11 | 154.4 | 5.9 | -5.4 | -3.9 | -1.5 | -11.3 | -5.6 | -5.7 | -11.7 | -7.6 | -4.1 | 14.9 | 14.8 | 0.0 | 7.6 | 7.9 | -0.4 | | | | 6.6 | 6.5 | 0.1 |
| Emerging Markets Fund- Schroder | FTSE All World Emerging Market Index | Oct-11 | 176.8 | 6.7 | -5.1 | -3.9 | -1.2 | -6.0 | -5.6 | -0.4 | -7.4 | -7.6 | 0.2 | 15.7 | 14.8 | 0.8 | 9.3 | 7.9 | 1.4 | | | | 7.9 | 5.9 | 2.1 |
| *Total Passive Equity Fund* | Client Specific Weighted Index | Mar-16 | 808.7 | 30.8 | -10.8 | -10.7 | -0.2 | -0.4 | -1.2 | 0.8 | -6.4 | -7.0 | 0.6 | | | | | | | | | | 9.5 | 9.1 | 0.4 |
| UK Equity Fund - L&G | FTSE All Share Index | Dec-15 | 354.6 | 13.5 | -10.2 | -10.2 | 0.1 | -2.7 | -2.8 | 0.1 | -9.3 | -9.5 | 0.1 | 6.4 | 6.1 | 0.2 | | | | | | | 7.5 | 7.3 | 0.2 |
| North American Equity Fund- L&G | FTSE All World North American Index | Dec-15 | 285.7 | 10.9 | -11.5 | -11.5 | 0.0 | 5.7 | 5.6 | 0.2 | 0.9 | 0.8 | 0.1 | 14.6 | 14.6 | 0.0 | | | | | | | 15.2 | 15.2 | 0.0 |
| Europe ex UK Equity Fund- L&G | FTSE Developed Europe Ex. UK Index | Dec-15 | 168.5 | 6.4 | -11.0 | -11.0 | 0.0 | -4.9 | -4.7 | -0.2 | -9.1 | -9.1 | 0.0 | 8.2 | 8.4 | -0.2 | | | | | | | 9.2 | 9.4 | -0.2 |
| *Total Alternatives Fund* | Client Specific Weighted Index | Mar-16 | 394.3 | 15.0 | -9.5 | -9.3 | -0.2 | 3.3 | 3.7 | -0.4 | -1.8 | -1.3 | -0.5 | | | | | | | | | | 11.4 | 11.8 | -0.4 |
| FTSE RAFI DEV Fund - L&G | FTSE RAFI Developed 1000 QSR Net Index | Dec-15 | 153.0 | 5.8 | -10.9 | -10.9 | 0.0 | -0.1 | -0.2 | 0.1 | -5.9 | -6.0 | 0.1 | 11.5 | 11.6 | -0.1 | | | | | | | 12.6 | 12.7 | -0.1 |
| MSCI World Min Vol TR Fund - L&G | MSCI World Minimum Volatility Net Index | Dec-15 | 119.1 | 4.5 | -5.5 | -5.5 | 0.0 | 6.9 | 6.9 | 0.0 | 1.4 | 1.4 | 0.0 | 12.4 | 12.4 | 0.0 | | | | | | | 13.5 | 13.5 | 0.0 |
| MSCI World Quality TR Fund - L&G | MSCI World Quality Total Return Net Index | Dec-15 | 122.2 | 4.7 | -11.6 | -11.6 | 0.0 | 4.3 | 4.3 | 0.0 | 0.8 | 0.8 | 0.0 | 13.4 | 13.5 | -0.1 | | | | | | | 14.1 | 14.2 | -0.1 |
| *Equity Protection - River & Mercantile* | | Jan-18 | 283.1 | 10.8 | 28.5 | 0.0 | 28.5 | 10.4 | 0.0 | 10.4 | 22.7 | 0.0 | 22.7 | | | | | | | | | | 22.7 | 0.0 | 22.7 |
| **Corporate Bond Fund- JPM** | **Barclays Capital Global Aggregate - Ex Treasury, Ex Government Related 100% Hedged to GBP** | **Mar-03** | **139.1** | **5.3** | **-1.0** | **-0.4** | **-0.6** | **-1.4** | **-0.9** | **-0.5** | **-3.2** | **-2.7** | **-0.6** | **2.7** | **2.5** | **0.2** | **3.3** | **3.1** | **0.2** | **5.0** | **4.5** | **0.5** | **4.8** | **5.0** | **-0.2** |
| **FQT Mid-Market Credit II** | **Absolute Return + 6.5%** | **May-18** | **5.6** | **0.2** | **1.5** | **1.6** | **-0.1** | | | | | | | | | | | | | | | | **8.0** | **4.3** | **3.7** |
| **Total Property Fund** | **Client Specific Weighted Index** | **Mar-16** | **136.3** | **5.2** | **2.1** | **1.7** | **0.4** | **6.3** | **5.2** | **1.1** | **6.5** | **7.0** | **-0.5** | | | | | | | | | | **9.3** | **7.1** | **2.2** |
| Total UK Property Fund | Absolute Return +9% | Jul-18 | 29.1 | 1.1 | 2.1 | 2.2 | -0.1 | | | | | | | | | | | | | | | | 2.1 | 9.0 | -6.9 |
| UK Property Fund - Invesco | Absolute Return +9% | Oct-17 | 2.0 | 0.1 | 0.0 | 2.2 | -2.2 | | | | | | | | | | | | | | | | 0.0 | 9.0 | -9.0 |
| UK Property Fund - VENN | Absolute Return +9% | Jul-15 | 27.1 | 1.0 | 2.3 | 2.2 | 0.1 | 4.4 | 6.7 | -2.3 | 7.1 | 9.0 | -1.9 | 11.7 | 9.0 | 2.7 | | | | | | | 10.9 | 9.2 | 1.7 |
| US Property Fund- Walton Street GBP | Absolute Return + 6.5% | Feb-16 | 14.6 | 0.6 | 3.2 | 1.6 | 1.6 | 11.6 | 4.8 | 6.7 | 8.4 | 6.5 | 1.9 | | | | | | | | | | 13.3 | 6.1 | 7.2 |
| US Property Fund- Walton Street USD | N/A | Feb-16 | 19.0 | N/A | 1.9 | 0.0 | 1.9 | 3.8 | 0.0 | 3.8 | 4.5 | 0.0 | 4.5 | | | | | | | | | | 8.6 | 0.0 | 8.6 |
| Euro Property Fund- Invesco | Absolute Return + 6.5% | Feb-16 | 72.7 | 2.8 | 2.1 | 1.6 | 0.5 | 6.1 | 4.8 | 1.3 | 6.1 | 6.5 | -0.4 | | | | | | | | | | 9.8 | 6.2 | 3.5 |
| Property Fund- AEW | Absolute Return + 6.5% | Oct-17 | 19.9 | 0.8 | 1.4 | 1.6 | -0.2 | 6.5 | 4.8 | 1.7 | 8.0 | 6.5 | 1.5 | | | | | | | | | | 6.1 | 6.5 | -0.4 |
| **Total Infrastructure Fund** | **Client Specific Weighted Index** | **Mar-16** | **161.5** | **6.1** | **2.2** | **2.0** | **0.1** | **1.9** | **6.2** | **-4.3** | **7.0** | **8.2** | **-1.2** | | | | | | | | | | **8.3** | **8.1** | **0.3** |
| UK Infrastructure Fund - Green | Absolute Return +7.6% | Apr-15 | 49.8 | 1.9 | 1.4 | 1.8 | -0.4 | 2.5 | 5.6 | -3.1 | 5.8 | 7.6 | -1.8 | 5.9 | 7.6 | -1.7 | | | | | | | 5.3 | 7.6 | -2.3 |
| UK Infrastructure Core Fund - Hermes | Absolute Return +8.4% | May-15 | 40.8 | 1.6 | 1.7 | 2.0 | -0.3 | -1.3 | 6.2 | -7.5 | 4.4 | 8.4 | -4.0 | 7.7 | 8.4 | -0.7 | | | | | | | 7.2 | 8.4 | -1.2 |
| UK Infrastructure Fund - Hermes II | Absolute Return +8.5% | Jun-18 | 8.8 | 0.3 | 5.6 | 2.1 | 3.5 | | | | | | | | | | | | | | | | 2.2 | 4.9 | -2.6 |
| Infrastructure Core Fund - Stonepeak | Absolute Return +12% | Jan-18 | 8.3 | 0.3 | 1.0 | 2.9 | -1.9 | -2.7 | 8.9 | -11.6 | -15.9 | 12.0 | -27.9 | | | | | | | | | | -15.9 | 12.0 | -27.9 |
| First State Fund | Absolute Return +9% | Jun-18 | 53.8 | 2.0 | 5.4 | 2.2 | 3.2 | | | | | | | | | | | | | | | | 9.8 | 5.2 | 4.6 |
| **Worcestershire CC Total Fund** | | **Mar-87** | **2,626.5** | **100.0** | **-5.2** | **-7.6** | **2.3** | **-0.4** | **-0.8** | **0.4** | **-3.8** | **-4.9** | **1.1** | **10.6** | **9.4** | **1.2** | **8.1** | **7.4** | **0.7** | **9.8** | **9.5** | **0.3** | **7.9** | **8.3** | **-0.4** |

**PF = Portfolio Return BM = Benchmark Return ER = Excess Return**

**Total Fund Benchmark**

**CLIENT SPECIFIC BM AS AT JUNE 2017:**

25.5% FTSE All Share
11% FTSE All World North America
9.5% FTSE Developed Europe Ex UK
12% FTSE Developed Asia Pacific
12% FTSE All World Emerging Markets
10% 1/3 FTSE RAFI DEV 1000 QSR Total Return NET & 1/3 MSCI World Minimum Vol Total Return NET & 1/3 MSCI World Quality Total Return NET
Corp Bonds: 10% Barclays Global Agg Corporate Bond HEDGED into GBP
Property: Weighted Client Specific Index
Infrastructure: Weighted Client Specific Index

**Notes:**

For the Total Fund benchmark the weightings for the Infrastructure and Property will match the actual drawdowns/market values of the funds, then the remainder will be put into UK Passive Equities .

Fees/fund charges have been taken into accound for the Total Fund return. Fees were found within the data for Hermes in July and L&G for August. The fees applied may not be final or all of the fees for Worcestershire CC Total Fund Portfolio.

Total Infrastructure and Total Property are measured against a weighted index of the funds underlying benchmarks.

Historic data up to and including 31.03.2016 has been provided by the WM Co and L&G.

Total Fund Reconciliation Analysis
Worcestershire County Council Pension Fund
for Quarter Ended 31st December 2018

Market Value: £2.6bn

| | 30th Sep 2018 | | Net | Total | Total | 31st Dec 2018 | |
|---|---|---|---|---|---|---|---|
| | Market Val (£000s) | Exposure (%) | Investment (£000s) | Income (£000s) | Gain/Loss (£000s) | Market Val (£000s) | Exposure (%) |
| **Total Equity Fund** | **2,422,809** | **85.9** | **-90,000** | **0** | **-148,820** | **2,183,989** | **83.2** |
| *Total Active Equity Fund* | 796,166 | 28.2 | -30,000 | 0 | -68,265 | 697,901 | 26.6 |
| Far East Developed Fund - Nomura | 446,668 | 15.8 | -30,000 | 0 | -50,004 | 366,664 | 14.0 |
| Emerging Markets Fund - JPM | 163,182 | 5.8 | 0 | 0 | -8,793 | 154,388 | 5.9 |
| Emerging Markets Fund- Schroder | 186,317 | 6.6 | 0 | 0 | -9,468 | 176,848 | 6.7 |
| *Total Passive Equity Fund* | 970,440 | 34.4 | -60,000 | 0 | -101,747 | 808,693 | 30.8 |
| UK Equity Fund - L&G | 422,537 | 15.0 | -25,900 | 0 | -42,083 | 354,554 | 13.5 |
| North American Equity Fund- L&G | 345,352 | 12.2 | -21,807 | 0 | -37,873 | 285,673 | 10.9 |
| Europe ex UK Equity Fund- L&G | 202,552 | 7.2 | -12,293 | 0 | -21,792 | 168,466 | 6.4 |
| *Total Alternatives Fund* | 435,853 | 15.4 | 0 | 0 | -41,554 | 394,299 | 15.0 |
| FTSE RAFI DEV Fund - L&G | 171,677 | 6.1 | 0 | 0 | -18,648 | 153,029 | 5.8 |
| MSCI World Min Vol TR Fund - L&G | 125,999 | 4.5 | 0 | 0 | -6,896 | 119,103 | 4.5 |
| MSCI World Quality TR Fund - L&G | 138,176 | 4.9 | 0 | 0 | -16,010 | 122,166 | 4.7 |
| Equity Protection - River & Mercantile | 220,350 | 7.8 | 0 | 0 | 62,746 | 283,096 | **10.8** |
| **Corporate Bond Fund- JPM** | **140,553** | **5.0** | **0** | **0** | **-1,403** | **139,150** | **5.3** |
| **EQT Mid-Market Credit II** | **5,223** | **0.2** | **0** | **0** | **397** | **5,620** | **0.2** |
| **Total Property Fund** | **133,703** | **4.7** | **-2,135** | **170** | **4,695** | **136,263** | **5.2** |
| Total UK Property Fund | 0 | 0.0 | 277 | 0 | 28,800 | 29,077 | 1.1 |
| UK Property Fund - Invesco | 0 | 0.0 | 2,003 | 0 | 0 | 2,003 | 0.1 |
| UK Property Fund - VENN | 28,160 | 1.0 | -1,726 | 0 | 640 | 27,074 | 1.0 |
| US Property Fund- Walton Street | 13,998 | 0.5 | 157 | 0 | 448 | 14,603 | 0.6 |
| Euro Property Fund- Invesco | 71,767 | 2.5 | -565 | 0 | 1,496 | 72,697 | 2.8 |
| Property Fund- AEW | 19,778 | 0.7 | 0 | 170 | 107 | 19,886 | 0.8 |
| **Total Infrastructure Fund** | **118,944** | **4.2** | **39,892** | **0** | **2,640** | **161,477** | **6.1** |
| UK Infrastructure Fund - Green | 49,795 | 1.8 | -722 | 0 | 714 | 49,786 | 1.9 |
| UK Infrastructure Core Fund - Hermes | 40,620 | 1.4 | -504 | 0 | 685 | 40,801 | 1.6 |
| UK Infrastructure Fund - Hermes II | 4,990 | 0.2 | 3,444 | 0 | 318 | 8,753 | 0.3 |
| First State Fund | 15,753 | 0.6 | 37,231 | 0 | 845 | 53,829 | 2.0 |
| Infrastructure Core Fund - Stonepeak | 7,786 | 0.3 | 443 | 0 | 78 | 8,307 | 0.3 |
| **Cash Fund** | **0** | **0.0** | **51,924** | **0** | **-51,924** | **0** | **0.0** |
| **Worcestershire CC Total Fund** | **2,821,232** | **100.0** | **-318** | **170** | **-194,415** | **2,626,498** | **100.0** |

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Local Authority Pension Fund Forum

The Local Authority Pension Fund Forum (LAPFF) exists to promote the long-term investment interests of member funds and beneficiaries, and to maximise their influence as shareholders whilst promoting the highest standards of corporate governance and corporate responsibility at investee companies. Formed in 1990, LAPFF brings together a diverse range of 79 public sector pension funds and five pools in the UK with combined assets of over £230 billion.

# QUARTERLY ENGAGEMENT REPORT

OCTOBER TO DECEMBER 2018

LAPFF raises the stakes and calls for a shareholder resolution at Ryanair

AGM attendance raises operational risk of joint ventures in relation to Samarco dam

Competition and Markets Authority final report devotes an appendix to LAPFF's 'expectations gap' on audit quality

Kingman Review recommends disbanding the FRC in line with LAPFF position

Affordability and climate risk strategy explored in meetings with construction firms and housebuilders

Regulatory and other challenges of plastic waste and pollution addressed with consumer goods and packaging companies

# Executive Summary

Concerned about the continuing human capital management and governance issues at Ryanair, the Forum announced a proposal to file a shareholder resolution ahead of the company's 2019 AGM, with the aim of replacing the current Chair David Bonderman, who has been on the board for 22 years, and ensuring that a coherent succession plan is in place for Chief Executive Michael O'Leary. Despite numerous efforts to meet with a Board member, Ryanair has not yet agreed to such a meeting.

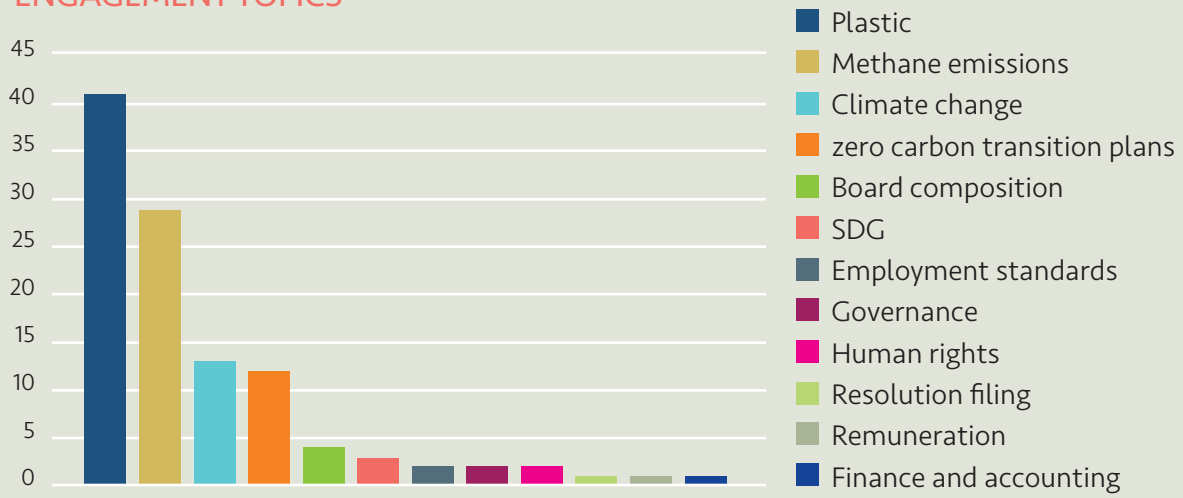
The Forum also progressed work on the topic of plastics, joining a coalition of investors engaging with companies on the overall threats posed by plastic waste and pollution. The Forum met with two companies on this, as well as discussing the use of single-use plastic specifically. Additionally, the Forum co-signed a letter to a range of companies on reducing plastic pellet loss.

The quarter saw many engagements with Board members of housebuilders and construction companies on the topic of sustainable cities and climate risk management. Part of a broader topic of Sustainable Development Goals, these meetings sought to broaden the Forum's understanding of how these companies approach issues around planning and affordability, and seek assurance that tackling climate change is integral to the business strategy.

During this quarter, LAPFF engaged with 95 companies on issues ranging from human capital management and Board composition to climate change reporting and sustainability.

# Company Engagement

ENGAGEMENT TOPICS



## SOCIAL RISK

*Michael O'Leary*

**Ryanair**
In continuing attempts to meet with members of the **Ryanair** Board, Acting Chair Cllr Paul Doughty attended the AGM and reiterated a request to meeting, but this was not secured. Following a failure to listen to shareholders' concerns after almost 30% of voted against Mr Bonderman's re-election at the September AGM, LAPFF announced plans to file a shareholder resolution at the 2019 AGM that would recommend the Company replace Mr Bonderman and set out succession plans for Chief Executive Michael O'Leary.

**Social Risks and Poor Management at BHP and Sports Direct**
During the quarter, Cllr Paul Doughty attended **BHP Billiton's** AGM, where he inquired about operational risks of joint ventures, specifically in relation to the Samarco dam. While the company noted that a different approach to joint ventures would not have prevented Samarco, BHP learned a number of lessons from the tragedy. The Forum also met with community members affected by the Samarco dam collapse to listen to their personal experiences and to assess what additional issues can be raised with the company in the future.

At **Sports Direct's** AGM in December, Cllr Doughty inquired about the current acquisition strategy which might not be appropriate to create sufficient value for shareholders. The Forum questioned the company's reasoning behind acquiring struggling high street retailers House of Fraser and Evans Cycles, in light of Michael Ashely's comments that the 'high street is dying'. Sports Direct assured the Forum that all efforts will be paid to save the high street and shareholder assets will be protected. When asked about including an independent body in the selection process of a workers representative, the company did not comment.

Following a meeting with the Vice President of investor relations representative earlier this year, LAPFF wrote to the Lead Independent Director of **Motorola Solutions**, requesting a meeting to discuss the Company's human rights policy and due diligence processes relating to operation in the Occupied Palestinian Territories.

LAPFF continued to engage with companies on gender diversity through its membership in the 30% Club Investor Group, which currently has a focus of UK companies in the energy sector. The group is also reaching out to search firms to ensure that they fully embrace the voluntary code of conduct on diversity.

**'Expectations Gap is a Red Herring': LAPFF Responds to Competition and Markets Authority**
The LAPFF response to the Competition and Markets Authority (CMA) consultation on the UK audit market, submitted on 29 October 2018, highlighted the deficiencies of the Financial Reporting Council and the standards and inspection regimes under that. LAPFF received a very quick response from the enquiry and a meeting was held with the acting chair of LAPFF on 13 November. The officials met were very engaged on the issues, and given similar information from the investor coalition that LAPFF has been a member of, the subject of the legal opinions of George Bompas QC for LAPFF was discussed in detail.

The matter of the auditors' claim of an 'expectation gap' between what they are supposed to do and what the public expects them to do, came up. The final CMA report devoted an appendix chapter to the subject. It states that 'LAPFF described the expectations gap as a red herring. LAPFF argued that the audit quality problem is a result of the industry's misinterpretation of the existing legal framework. In short, if the existing regime was interpreted and applied properly, the expectation gap would disappear because the current legal framework should be robust enough to produce the quality outcomes stakeholders expect.'

The CMA report also made far reaching recommendations to reform the UK audit market. Firstly, separating the consulting parts of accounting firms from audit, a form of ring fencing. Secondly, requiring that FTSE 350 companies must have joint auditors, the second auditor not being one of the Big 4.

On the same day the Kingman Review reported on the future of the Financial Reporting Council. It recommends, in line with the LAPFF position, that the FRC is disbanded and replaced with a statutory body constituted by Parliament. The Review recommends this as the Auditing, Reporting and Governance Authority.

**Governance at Housebuilders and Glencore**
With the aim of gaining a better understanding of companies' approach to the Sustainable Development Goals, in particular the goal on sustainable cities and communities, LAPFF met with a number of housebuilders and construction companies. At a meeting with the Chair of **Persimmon**, Roger Devlin, LAPFF Vice Chair Cllr Doug McMurdo asked about issues around planning and the Help to Buy scheme. On climate risk management, the Company expressed interest in measuring Scope 3 emissions. The Forum was also interested to hear the company's plan to repair its damaged reputation over executive payouts, following opposition from 49% of shareholders on remuneration for Chief Executive, Jeff Fairburn.

©Jim Barton

At a meeting on the same topic with Kevin Beeston, the Chair of **Taylor Wimpey**, Cllr McMurdo inquired about the sustainability of the Help to Buy scheme and the company's relationship with central government. The company then discussed climate risk management and assured LAPFF that science-based targets will be set. Diversity across the business was also a topic of discussion. The overall approach to sustainable cities and other development goals was also raised with the chief executive of **Barratt Developments**, David Thomas. The meeting discussed standards for homes, noting the board's focus on climate risk, which includes adaptation measures taken in siting for flooding as well as the need for science-based targets.

Along with other investors, including Sarasin and Church Commissioners, LAPFF met with Tony Hayward, the Chair of **Glencore** to ensure that the company has appropriate measures in place to deal with bribery and corruption. Investors present were also proposing that the company undergoes an independent review of its internal controls, to which Glencore committed to.

LAPFF also expressed its concern over **Amazon's** lack of meaningful engagement with its shareholders, despite concerns related to management of of certain environmental, social and governance matters. In a collaborative letter to the company, signatories noted their interest in filing a resolution if no response is received.

At **Rio Tinto's** ESG Forum hosted by the Chair, the Board as well as senior management, company representatives discussed the importance of incorporating ESG in business strategy and communicating about potential issues with shareholders. During a Q&A, investors engaged on a range of topics including relationship with employees and unions, fatality rate and joint ventures, as well as climate-related financial disclosure and climate change competence at Board level.

## ENVIRONMENTAL AND CARBON RISK

**Tackling Climate Risk at Oil and Gas Companies**
One of the big stories of the quarter, was **Royal Dutch Shell** publishing a joint statement with Climate Action 100+ lead investors, setting out its corporate strategy to implement its commitment made in 2018 which was to reduce the *Net Carbon Footprint* of its energy products by around half by 2050. Specific milestones include targets linked to remuneration, annual reporting on the progress, alignment with the TCFD recommendations and review of trade association memberships. Acting Chair Cllr Paul Doughty attended Shell's 'Board Day' in December. The Chair Chad Holliday was in attendance along with the Chairs of the Audit, Remuneration and CSR Committees and described various attributes of the board members that make them effective for Shell. Cllr Doughty asked Mr Holliday how environmental, social and governance standards can be respected through non-operated joint ventures in which Shell is involved. Cllr Doughty used the example of a recent communication by IndustriALL expressing concern about working conditions for contract workers at Shell operations.

An 'eight on eight' meeting of **BP** executives and 'Climate Action 100+' investors continued long-term regular engagement with the company. Discussions aimed to tease out further details on the company's strategy for the transition to a low carbon economy, including more information on target setting over the short, medium and long-term; ensuring capex on oil and gas development is aligned with the Paris agreement and provision of information on emissions associated with the production and use of the company's products.

The focus on the oil and gas companies does not diminish, and in December, under a tight time-frame, funds were offered the opportunity to co-file a shareholder resolution to **ExxonMobil** as part of Climate Action 100+ engagement. The resolution called for the company to disclose short, medium and long-term greenhouse gas targets aligned the Paris Climate Agreement.

Along with a group of 61 investors, the Forum asked 30 companies to declare their support for continued US Environmental Protection Agency (EPA) regulation of methane emissions and to oppose the elimination of direct regulation of methane emissions. Natural gas is almost entirely methane which is 87 times more potent in global heating than carbon dioxide over a twenty year period. If emissions from gas production, storage and delivery exceed 2% of gas produced, there is no climate benefit compared to coal. The participating investors believe that

rolling back current methane regulation would be a threat to long-term viability of the oil and gas sector.

***Utilities and clean energy***

A meeting with **National Grid** co-ordinated by Climate Action 100+ provided encouraging news that the group will look at a 1.5 degree scenario. Cllr Robert Chapman asked about the most positive areas of 'value change' for shareholders. In the response, the decarbonisation of transport was cited, with further information provided on the timescale for the role out of charging points around the UK's motorway system. The different market forces at work in the UK and US businesses are very apparent. National Grid works closely with consumers in its US operations where Massachusetts, New York and Rode Island have each adopted targets mandating an 80% reduction in $CO_2$ emissions by 2050 across their entire economies. The Group is working in a number of areas to progress this including energy efficiency, micro-grids and geothermal.

During a meeting with **Southern Company**, co-ordinated by the 50 50 initiative, company representatives talked about the reasons for not having a separate Climate Committee, but instead delegating to the operations committee to address climate risks. The meeting also discussed climate-related disclosure and the use of climate-related metrics as part of executive remuneration.

LAPFF joined other Climate Action 100+ investors in writing to a number of utility companies, urging them to accelerate decarbonisation by setting out transition plans to net-zero carbon economy. Signatories also called on companies to support the development of ambitious climate policy and ensure that their trade associations are aligned with this objective.

***Cross sectoral engagement***

A first meeting was held with **ArcelorMittal** under the aeigis of the Climate Action 100+ Group. The meeting covered governance of climate risk at the company and plans for emission reductions through the use of low carbon technologies across operations. Scenario planning, target setting and Taskforce on Climate-related Financial Disclosure reporting were also discussed.

A collaborative conference call, was held with **General Electric Company** to follow up on an letter sent earlier in the year on the climatic impacts of the proposed Amu Power coal project in Kenya. On the call, company representatives committed only to listen to questions and provide written answers. LAPFF asked if the company had considered how prices quoted for coal versus renewables might change over a two to five year time frame, and their view on renewables. A follow-up letter to the company set out a range of issues, including on this point, by asking for the levelised cost of electricity the company used in its evaluation.

LAPFF has signed on to an Investor Statement supporting a just transition to a low-carbon economy. This statement recognises that the social impact of a low-carbon energy transition is often overlooked. However, to avoid stranded workers and stranded communities, as well as stranded physical assets, and to facilitate a smooth transition, social impacts need to be considered.

LAPFF also signed a statement from the Investor Working Group on Sustainable Palm Oil, which highlighted what investors' expect of companies regarding sustainable palm oil, and asks companies operating across the palm oil value chain to adopt and publicly disclose a 'no deforestation, no peat, no exploitation' policy. The statement serves to update an early position paper (signed by LAPFF).

FCA FINANCIAL CONDUCT AUTHORITY An exchange of correspondence with the Financial Conduct Authority (FCA) aimed to better understand how shareholder resolutions are being dealt with at dual-listed companies and to prompt the FCA to promote better practice in the regulatory framework for shareholder accountability. The Forum was specifically concerned with a resolution on climate change at Rio Tinto and reiterated to the FCA that climate risk is a pressing policy issue that affects all companies.

**Plastics: 2025 Target for Biodegradable, Compostable and Recyclable Materials at PepsiCo and Nestlé**

As a member of the Plastic Solutions Investor Alliance, the Forum engages with consumer goods companies on the overall threats posed by plastic waste and pollution. In November, the Forum participated in a collaborative call with **Nestlé** to discuss the company's global packaging commitment and the related challenges of moving towards a more circular plastic economy. Plastic packaging and pollution was also discussed with **PepsiCo**. The company discussed plans to solely use plastic that is biodegradable, compostable and recyclable by 2025. Both companies expressed concerns over the challenges of having global operations with different regulations. The two companies are working together to achieve the 2025 target.

The Forum has also signed an investor letter urging companies to commit to zero plastic pellet loss across their whole business and to assess and report on all progress. Plastic pellets are used to create almost all plastic products and it is estimated that over 200 thousand tonnes of pellets or other micro-plastics enter the ocean each year[1]. The letter was sent to over 40 companies in associated supply chains which included plastic manufacturers, plastic packaging manufacturers, transport and logistic companies, retailers and consumer companies.

[1]Eunomia (2016) Plastics in the Marine Environment http://www.eunomia.co.uk/reports-tools/plastics-in-the-marine-environment/

## MEDIA COVERAGE

### Ryanair: Pressure for a New Chair

Ryanair hits headwinds in 2018, but is still well placed to grow – Irish Times, 26 December 2018

Ryanair, O'Leary sotto l'assedio dei fondi inglesi – First Online, 9 November 2018

Investoren fordern Ablsung des Ryanair-Verwal-tungsratschefs – Ariva.de, 5 November 2018

ESG Roundup: UK public sector schemes to oppose Ryanair chairman – IPE, 30 October 2018

Pension funds heal pressure on Ryanair to ditch chairman – The Times, 29 October 2018

Pension fund revives efforts to change Ryanair leadership – LGC, 29 October 2018

Council pension fund forum calls for Ryanair chair to step down – LocalGov, 29 October 2019

Ryanair investors square up for second fight over chairman Bonderman – Independent, 29 October 2018

Ryanair investors call for chairman to go, CEO succession plan - media reports – ProactiveInvestors, 29 October 2018

Crisis en Ryanair: nueva conspiracion interna para que el presidente dimita – preferente.com, 29 October 2018

Ryanair investors call for chairman to stand down in 2019 – The Guardian, 28 October 2018

Ryanair shareholder reignites calls to replace chairman – Financial Times, 28 October 2018

Ryanair shareholder gear up for fresh call to ditch chair – The Telegraph, 28 October 2018

Ryanair shareholder calls for chairman's ouster – Reuters, 28 October 2018

Ryanair shareholders call for chairman David Bonderman to be replaced - ITV, 28 October 2018

Un actionnaire de Ryanair demande l'eviction du president – Capital, 28 October 2018


### Reliable Accounts: Challenging the Auditors

Kingman review proposes replacing FRC with new, stronger regulator – IPE, 18 December 2018

Big Four warns against breaking up UK audit firms – Financial Times, 13 November 2018

Chief executive of audit watchdog to step down amid independent probe – IPE, 2 November 2018

'Total failure of a political ideology': SNP MP blasts outsourcing industry at #SNP18 fringe – Common-Space, 9 October 2018

### Utilities and the Drive to Zero Carbon

Power companies must accelerate decarbonisation and support ambitious climate policy – Financial Times, 20 December 2018

### Asset Managers and ESG

£230bn pensions body tells AMs to 'up your game' on ESG – Citywire Selector, 20 December 2018

Public pension funds 'underwhelmed' by managers on ESG – IPE, 20 December 2018

Pension funds criticise asset managers over lax ESG approach – LGC, 19 December 2018

Mitigating the investment risks of rising income inequality – Impact Alpha, 8 November 2018

For the LGPS, ESG is a shared priority with a split approach – LGC, 22 October 2018

## COMPANY PROGRESS REPORT

95 companies engaged over the quarter

### Q4 2018 ENGAGEMENT DATA

| Company | Activity | Topic | Outcome |
|---|---|---|---|
| ALIBABA GROUP HOLDING LIMITED | Letter | Commit to zero plastic pellet loss | Dialogue |
| AMCOR LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| AMOREPACIFIC CORP | Letter | Commit to zero plastic pellet loss | Dialogue |
| ANADARKO PETROLEUM CORPORATION | Letter | Support methane emissions regulation | Dialogue |
| ANTERO RESOURCES | Letter | Support methane emissions regulation | Dialogue |
| APACHE | Letter | Support methane emissions regulation | Dialogue |
| ARCELORMITTAL SA | Meeting | Climate Change | Change in Process |
| BARRATT DEVELOPMENTS PLC | Meeting | Other (SDG)/Climate Change | Satisfactory Response |
| BASF SE | Letter | Commit to zero plastic pellet loss | Dialogue |
| BEIERSDORF AG | Letter | Commit to zero plastic pellet loss | Dialogue |
| BEMIS COMPANY INC | Letter | Commit to zero plastic pellet loss | Dialogue |
| BHP GROUP PLC (GBR) | AGM | Governance (Joint ventures)/ Human Rights | Dialogue |
| BP PLC | Meeting/ Letter | Climate Change/ Support methane emissions regulation | Small Improvement |
| C.H. ROBINSON WORLDWIDE INC. | Letter | Commit to zero plastic pellet loss | Dialogue |
| CABOT OIL & GAS | Letter | Support methane emissions regulation | Dialogue |
| CENTRICA | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| CEZ | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| CHESAPEAKE ENERGY CORPORATION | Letter | Support methane emissions regulation | Dialogue |
| CHEVRON | Letter | Support methane emissions regulation | Dialogue |
| CIMAREX ENERGY | Letter | Support methane emissions regulation | Dialogue |
| CONOCOPHILLIPS | Letter | Support methane emissions regulation | Dialogue |
| CONTINENTAL RESOURCES | Letter | Support methane emissions regulation | Dialogue |
| COVESTRO AG | Letter | Commit to zero plastic pellet loss | Dialogue |
| DAIRY FARM INTL HOLDINGS LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| DEVON ENERGY | Letter | Support methane emissions regulation | Dialogue |
| DIAMONDBACK ENERGY, INC. | Letter | Support methane emissions regulation | Dialogue |
| DOW DUPONT COMPANY | Letter | Commit to zero plastic pellet loss | Dialogue |
| DSV A/S | Letter | Commit to zero plastic pellet loss | Dialogue |
| E.ON SE | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| EASTMAN CHEMICAL COMPANY | Letter | Commit to zero plastic pellet loss | Dialogue |
| EDF | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| ENBRIDGE | Letter | Support methane emissions regulation | Dialogue |
| ENCANA | Letter | Support methane emissions regulation | Dialogue |
| ENEL SpA | Letter | Set out transition plans to net-zero carbon economy | Dialogue |

## Q4 2018 ENGAGEMENT DATA

| Company | Activity | Topic | Outcome |
|---|---|---|---|
| ENGIE | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| EOG RESOURCES | Letter | Support methane emissions regulation | Dialogue |
| EQT | Letter | Support methane emissions regulation | Dialogue |
| EQUINOR/ SATOIL | Letter | Support methane emissions regulation | Dialogue |
| EXPEDITORS INTERNATIONAL OF WASHINGTON INC. | Letter | Commit to zero plastic pellet loss | Dialogue |
| EXXON MOBIL CORPORATION | Letter | Commit to zero plastic pellet loss/ Climate Change | Dialogue |
| FORTUM OYJ | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| GAS NATURAL SDG SA | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| GENERAL ELECTRIC COMPANY | Letter | Climate Change | Dialogue |
| GLENCORE PLC | Meeting | Governance (Corruption) | Small Improvement |
| GODREJ CONSUMER PRODUCT | Letter | Commit to zero plastic pellet loss | Dialogue |
| GREIF INC -CL A | Letter | Commit to zero plastic pellet loss | Dialogue |
| HESS CORPORATION | Letter | Support methane emissions regulation | Dialogue |
| IBERDROLA SA | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| JERONIMO MARTINS SGPS SA | Letter | Commit to zero plastic pellet loss | Dialogue |
| JOHNSON & JOHNSON | Letter | Commit to zero plastic pellet loss | Dialogue |
| KINDER MORGAN | Letter | Support methane emissions regulation | Dialogue |
| KUEHNE NAGEL INTERNATIONAL AG | Letter | Commit to zero plastic pellet loss | Dialogue |
| LG CHEMICAL LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| MARICO LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| MOTOROLA SOLUTIONS INC. | Letter | Human Rights | Dialogue |
| NATIONAL FUEL GAS | Letter | Support methane emissions regulation | Dialogue |
| NATIONAL GRID PLC | Meeting/Letter | Climate Change/Employment Standards/Set out transition plans to net-zero carbon economy | Moderate improvement |
| NATURA COSMETICOS SA | Letter | Commit to zero plastic pellet loss | Dialogue |
| NESTLÉ SA | Letter/Meeting | Commit to zero plastic pellet loss/ Environmental risk (plastic) | Small Improvement |
| NIPPON EXPRESS CO LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| NOBLE ENERGY | Letter | Support methane emissions regulation | Dialogue |
| OCCIDENTAL | Letter | Support methane emissions regulation | Dialogue |
| PANALPINA WELTTRANSPORT AG | Letter | Commit to zero plastic pellet loss | Dialogue |
| PEPSICO | Meeting | Environmental Risk (Plastic) | Change in Process |
| PERSIMMON PLC | Meeting | Other (SDG)/Climate Change/ Remuneration | Small Improvement |
| PETROCHINA CO LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| PIGEON CORP | Letter | Commit to zero plastic pellet loss | Dialogue |
| PIONEER NATURAL RESOURCES COMPANY | Letter | Support methane emissions regulation | Dialogue |
| QEP RESOURCES | Letter | Support methane emissions regulation | Dialogue |
| RANGE RESOURCES COMPANY | Letter | Support methane emissions regulation | Dialogue |

## Q4 2018 ENGAGEMENT DATA

| Company | Activity | Topic | Outcome |
|---|---|---|---|
| RELIANCE INDUSTRIES LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| REPSOL | Letter | Support methane emissions regulation | Dialogue |
| ROYAL DUTCH SHELL PLC | Meeting/Letter | Climate Change/Support methane emissions regulation | Moderate Improvement |
| RWE AKTIENGESELLSCHAFT | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| RYANAIR HOLDINGS PLC | Letter | Board Composition | Dialogue |
| SHOPRITE HOLDINGS LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| SONOCO PRODUCTS COMPANY | Letter | Commit to zero plastic pellet loss | Dialogue |
| SOUTHERN COMPANY | Meeting/Letter | Climate Change/ Set out transition plans to net-zero carbon economy | Small Improvement |
| SOUTHWESTERN | Letter | Support methane emissions regulation | Dialogue |
| SPORTS DIRECT INTERNATIONAL | Meeting | Finance and Accounting/ Employment Standards | Dialogue |
| SSE PLC | Letter | Set out transition plans to net-zero carbon economy | Dialogue |
| TAYLOR WIMPEY PLC | Meeting | Other (SDG)/ Climate Change | Satisfactory Response |
| TESCO PLC | Letter | Commit to zero plastic pellet loss | Dialogue |
| THE COCA-COLA COMPANY | Letter | Commit to zero plastic pellet loss | Dialogue |
| THE PROCTER & GAMBLE COMPANY | Letter | Commit to zero plastic pellet loss | Dialogue |
| TOYO SEIKAN KAISHA LTD | Letter | Commit to zero plastic pellet loss | Dialogue |
| UNILEVER PLC | Letter | Commit to zero plastic pellet loss | Dialogue |
| UNI-PRESIDENT ENTERPRISE CO | Letter | Commit to zero plastic pellet loss | Dialogue |
| WALMART INC. | Letter | Commit to zero plastic pellet loss | Dialogue |
| WHITING PETROLEUM CORP | Letter | Support methane emissions regulation | Dialogue |
| XPO LOGISTICS INC | Letter | Commit to zero plastic pellet loss | Dialogue |

## NETWORKS AND EVENTS

The following lists some of the events and meetings attended by or on behalf of LAPFF representatives during the quarter:

Local Authority Pension Fund Forum

The Forum's 23rd annual conference focused on the financial aspects of corporate governance. Presentations from Lord Davies, Baroness Brown, James Bloodworth and many others covered a wide range of topics including problematic accounting rules, executive remuneration, the climate crisis, plastics, human capital management risks and diversity.

global witness

At a collaborative meeting with Peter Jones of Global Witness, the Forum discussed Glencore's relationship with notorious businessman Dan Gertler and related corruption allegations. Global Witness provided three examples around the time of Glencore's IPO that suggested significant financial benefit to Mr Gertler, and no apparent commercial benefit to Glencore.

PRI

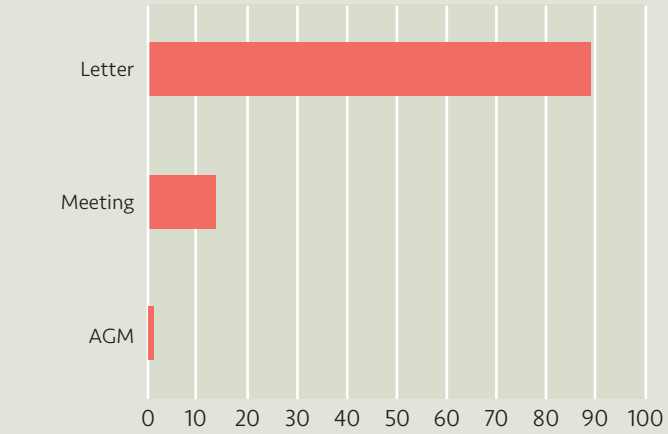
LAPFF Acting Chair, Cllr Paul Doughty, met with the Head of UK and Ireland at the Principles of Responsible Investment (PRI) in December. LAPFF has joined a number of PRI engagements in the past and the two organisations are continuing to look for ways to work together on the responsible investment agenda.
In October, the Forum attended a call with PRI to update signatories on cyber engagements and discuss next steps in escalating activities on this topic.

appg

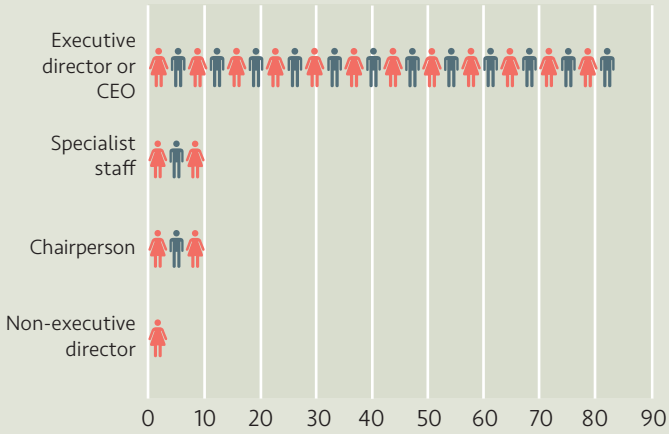
Tom Powdrill of the International Transport Workers' Federation, spoke about employment standards at Ryanair and the role of pension funds at the October meeting of the All Party-Parliamentary Group (APPG) on Local Authority Pension Funds. Chaired by Clive Betts MP, the meeting also covered the topic of localising pension fund investments, introduced by Craig Berry, a former employee of Sheffield Political Economy Research Institute. The minutes from the meeting can be accessed here.

## COMPANY ENGAGEMENT ACTIVITIES

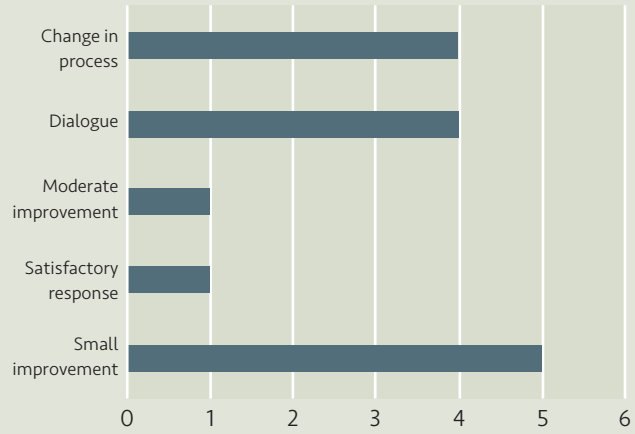
### Company engagement activities




### Position engaged




### Outcomes




### Company domiciles

## LOCAL AUTHORITY PENSION FUND FORUM MEMBERS

- Avon Pension Fund
- Barking and Dagenham LB
- Barnet LB
- Bedfordshire Pension Fund
- Border to Coast Pensions Partnership
- Cambridgeshire Pension Fund
- Camden LB
- Cardiff and Vale of Glamorgan Pension Fund
- Cheshire Pension Fund
- City and County of Swansea Pension Fund
- City of London Corporation
- Clwyd Pension Fund
- Cornwall Pension Fund
- Croydon LB
- Cumbria Pension Scheme
- Derbyshire CC
- Devon CC
- Dorset County Pension Fund
- Durham Pension Fund
- Dyfed Pension Fund
- Ealing LB
- East Riding Of Yorkshire Council
- East Sussex Pension Fund
- Enfield LB
- Environment Agency Pension Fund
- Falkirk Council
- Gloucestershire Pension Fund
- Greater Gwent Fund
- Greater Manchester Pension Fund
- Greenwich Pension Fund
- Gwynedd Pension Fund
- Hackney LB
- Hammersmith and Fulham LB
- Haringey LB
- Harrow LB
- Havering LB
- Hertfordshire County Council Pension Fund
- Hounslow LB
- Islington LB
- Lambeth LB
- Lancashire County Pension Fund
- Leicestershire Pension Fund
- Lewisham LB
- Lincolnshire CC
- London CIV
- London Pension Fund Authority
- Lothian Pension Fund
- Merseyside Pension Fund
- Merton LB
- Newham LB
- Norfolk Pension Fund
- North East Scotland Pension Fund
- North Yorkshire CC Pension Fund
- Northamptonshire CC
- Northern Pool
- Northumberland CC
- Nottinghamshire CC
- Oxfordshire Pension Fund
- Powys CC Pension Fund
- Redbridge LB
- Rhondda Cynon Taf
- Shropshire Council
- Somerset CC
- South Yorkshire Pension Authority
- Southwark LB
- Staffordshire Pension Fund
- Strathclyde Pension Fund
- Suffolk CC Pension Fund
- Surrey CC
- Sutton LB
- Teesside Pension Fund
- Tower Hamlets LB
- Tyne and Wear Pension Fund
- Wales Pension Partnership
- Waltham Forest LB
- Wandsworth LB
- Warwickshire Pension Fund
- West Midlands ITA Pension Fund
- West Midlands Pension Fund
- West Yorkshire Pension Fund
- Westminster LB
- Wiltshire CC
- Worcestershire CC

# Local Government Pension Scheme

## Statutory guidance on asset pooling

# Contents

**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.

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**Worcestershire County Council Pension fund – Proposed response to MHCLG LGPS Statutory guidance on asset pooling – 19th March 2019**

Dear Sirs,

**Local Government Pension Scheme**

**Statutory guidance on asset pooling**

Worcestershire County Council Pensions Fund (WCCPF) would like to thank the Government for recognising the achievement made to date by the eight asset pools across the LGPS. We agree that there is still much to do in terms of the delivery of the pooled vehicle investment offering by the pools and the transition of assets into the pool and therefore, we welcome the statutory guidance to assist us with that challenge, as well as the opportunity to comment on such.

As a Partner Fund of the LGPS Central Pool, we would ask the Government to recognise that, whilst asset pooling is intended to deliver wider benefits as well as cost savings across the LGPS more generally, there are some Partner Funds WCCPF being one of them, within the LGPS Central Pool where the cost savings will not be so apparent and transferring assets into pooled vehicles may indeed lead to an increase in costs. We would suggest that the current guidance is extended further to address this risk and provide support and advice to those Partner Funds such as ours that may be affected in this way. We would further add that it is important to acknowledge that all decisions about making an investment in a pooled vehicle should continue to be made locally, on a value for money basis, to ensure that these decisions do not run contrary to the fiduciary duty of Elected Members on Pensions Committees, who have a responsibility to act in the best interests of their Pension Fund and ensure value for money.

Our comments on the detail of the statutory guidance follow:

**2. Definitions**

The definitions are helpful in promoting the use of common terminology and we welcome the clear definition of 'pool governance body' and its role in setting the direction of the pool and holding the pool company to account (4.2).

We do feel that there is further clarity needed around the definition of 'Retained asset' and the reference to the transition period, which we infer to mean until 2020. This is contra to the concept of the retention of existing assets (5.4, 5.5 and 5.6), including Life funds and direct property which are subject to review at last every three years.

Likewise, the definition of 'Local assets' and its reference to new investments as opposed to the concept of Local assets (as described in 6.2) which are local initiatives and permitted to be held outside the pool on a permanent basis. Clarification would be helpful.

**3. Structure and Scale**

3.1 The measurement of '*gross risk adjusted returns'* versus what we might otherwise have invested in will be difficult to measure going forward. Strategic Asset Allocations will change going forwards anyway and it will not always be a case of comparing apples with apples. A consistent methodology for calculating risk adjusted returns would also be welcomed.

It would be helpful to understand whether Pool members are expected to have full knowledge of all underlying investment manager costs in a Pooled fund / vehicle i.e. full disclosure or if it is acceptable for reporting at the Pooled fund / vehicle level.

It should be recognised that whilst pooling does permit diversification across some asset classes, there is also an element of compromise involved in the specification of pooled funds/ vehicles and pool members are not always going to be able to invest in line with their specific asset allocation requirements.

Also, risk may not always be diversified if the decision is to invest significant assets with one investment manager.

3.2 Confirmation that pool members must appoint a pool company to implement their investment strategies, and that pool companies must be regulated entities is welcomed. This creates a level playing field and a more reliable basis for inter-pool comparison.

The last sentence of 3.2 needs clarification. '*Pool members may continue to decide if they wish to invest via in-house or externally managed vehicles'* is contradictory to the previous sentence '…..*pool companies to decide ….whether to use in-house or external management.* If pool companies are deciding whether to use external or in-house management, how can pool members have the choice of investing internally or externally, unless they do so outside the pool (or invest via another pool)? Whilst there is a general acceptance that in-house management can be delivered more cheaply than external management, this should not be at the risk of *'affecting gross risk-adjusted returns'* and therefore unless the internal team has a good performance track record, which is comparable to that of the external managers and one which stands up in an open procurement process, the decision to invest via in-house or via external managers must be retained by pool members and the pool company should offer both options through its pooled vehicles. There should be no automatic blending of both unless agreed by all pool members.

3.6 We are unsure as to why there is specific mention of active and passive management in this guidance as we feel the decision to invest in either should form part of a pool members decision making process in respect of Strategic Asset Allocation (4.2). The expectation of ongoing performance comparison may also prove difficult; some standard methodology for calculating risk adjusted returns has already been referred to.

**4. Governance**

4.2 Thank you for the emphasis that Strategic Asset Allocation remains the responsibility of pool members in recognition of an authority's specific liability profile and cash-flow needs.

4.4 Whilst we recognise the wider perspective and appreciate the need for a long-term view, one of the original four criteria for asset pooling was centred around cost savings and value for money. Whist the implementation costs of pooling can be recovered over a longer timescale, and this may also be true of transition costs in some cases, there needs to be ongoing savings for these costs to be recovered. Therefore, any sense of forcing funds to transfer assets into a pool at increased cost risks undermining the potential cost savings in the long-term. This also is against the fiduciary duty of Elected Members on Pensions Committees, who have a responsibility to act in the best interests of their Pension Fund

4.5 & 4.6 Recognising that Local Pension Boards have a role to play in the oversight of the governance of the pool is helpful, as is the flexibility for each pool to decide for themselves whether or not observers drawn from the Local Pension Board are included on pool governance bodies.

4.8 This is somewhat contradictory to 4.2 and would benefit from clarification. Tactical Asset Allocation decisions are typically short-term deviations from a pool members Strategic Asset Allocation and it therefore follows that these decisions should reside with individual pool members.

4.9 We agree that including an explanation of how the balance between the range of pool vehicles and reduced costs is reached is an appropriate thing to include in the Investment Strategy Statement albeit we are not sure it has a place in the Funding Strategy Statement. However, at this point of delivery we are unable to comment fully on this as our priority is the creating of sub-funds and transferring pool members assets into then so cost savings can be delivered. It may be more appropriate to defer this particular requirement to the 'business as usual' version of the guidance in due course.

**5. Transition of assets to the pool**

5.1 Transition of listed assets '…..over a relatively short period' is somewhat vague albeit the fact it is not prescriptive is helpful. However, the guidance should be expanded to recognise that the lead time required to set up FCA regulated sub-funds and transition assets into them will not always be possible over a relatively short period. Whilst time is a factor, it is more important that Pool companies are not pressured into employing excessive resources to speed up implementation in the short term, which may increase total costs above and beyond savings which could be delivered in the long term. Instead Pools should have criteria for assessing the prioritisation of the creation of new Pool vehicles. In LGPS Central for instance we have a set of 8 agreed criteria to help us determine what makes one sub-fund more important than another; Cost savings and Pool member inclusion being 2 of those criteria.

5.2 / 5.3 We welcome the clarity and permissions around cost-sharing.

5.4 Whilst this is helpful, it might be useful to state that government recognises that for some investments the time frame for retention may be significant e.g. for Illiquid asset classes such as Private Equity.

5.5 It is helpful to state that life funds, direct property, and some infrastructure investments may remain outside the Pool where the costs of transitioning could be significant. However, we feel strongly that this should be extended to recognise that it should also explicitly apply where the costs of managing any investments would be higher within a Pool fund or vehicle. This decision would form part of the Regular review of retained assets at least every three years (5.6) with the rationale for such a decision being clearly stated.

The ability to retain existing direct property assets outside the pool is also welcomed. However, the government is asked to recognise that these assets will continue to need active investment management in order that the property portfolio remains fit for purpose in terms of delivering income, capital growth and investment returns. Pool members must have the ability to re-shape their retained direct property portfolios in line with the market. This mitigates the risk of sub-optimal portfolios that simply cost money and result in a drag on performance i.e. the need to continue to buy, sell and undertake capital expenditure for development. (This ties in with 6.4).

In time Pool companies will provide appropriate Pool funds and vehicles for direct (and indirect property) which, in the first instance will be available for new/ additional Strategic Asset Allocations to property or for the unwinding of the costlier indirect vehicles. Again, these will need to be actively managed to avoid the same sub-optimal portfolio risks.

**6. Making investments outside the pool**

6.1 Whilst we are committed to being ambitious, we are realistic in our expectations that it will be extremely difficult for Pool companies to offer an adequate range of investment vehicles by 2020. Consideration should be given to extending this date.

6.2 See previous comment in Definitions regards Local assets.

6.4 Pool companies clearly need to be encouraged to offer the investment products that pool members need to deliver their investment strategy. However, this may not always be possible, and it should be acknowledged and reflected in the final guidance that in some instances holding assets outside the pool and/or making new investments outside the pool will be the only alternative; particularly where the provisions of 6.2 and 6.3 cannot be utilised.

There is no mention of what the expectation is of pool members taking opportunities with other pools if they are able to provide the investment required as opposed to the LGPS Central pool that we are currently part of.

Taking this a step further there is no mention of what the expectation is or the implications of pool members moving between pools

**7. Infrastructure Investment**

The adoption of the CIPFA definition of Infrastructure is welcomed as is the flexibility in respect of targets and methods of delivery.

**8. Reporting**

Given that the results of the CIPFA consultation are not yet available, albeit they are effective from 1 April 2019 and given that the closing date for this consultation is not until 29 March 2019, we anticipated that additional review for the purposes of alignment may be necessary.

Whilst we acknowledge the drive for fairer comparison across LGPS funds and pools, a great deal of information is being asked for across this Reporting section and at this stage, it is difficult to know what may or may not be readily available or easily accessible. The potential for additional resource requirements to manage increased levels of reporting across pools and within Pool member funds should also be recognised.

8.2 See previous comments in Definitions in respect of ‘retained assets’ and ‘local assets’. The reference to ‘transition plans for local assets’ would seem to be more appropriate for ‘retained assets’ i.e. ‘an existing investment retained by a pool member during the transition period’. A ‘local asset’ (2.1) is ‘a new investment by a pool member which is not a pooled asset’ – which in accordance with 6.1 and 6.2 are likely to be held outside the pool on a more permanent basis.

8.5 It is implicit that there may not be a specific end date for some assets being held outside the pool (5.5) and a high-level transition plan may not be appropriate. In these instances, being able to provide the rationale and cost implication of comparable pool vehicles together with the next review date should suffice.

In conclusion, we would like to reiterate our thanks for this guidance and for the opportunity to comment. There are a few anomalies identified and a number of areas where greater clarity would assist and not lead to wider misinterpretation, but we accept that we are all still progressing through a period of learning and there may be a need for more regular 'business as usual' updates to this guidance as we continue our LGPS pooling journey.

Yours faithfully,

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