Worcestershire County Council

Agenda

Pensions Committee

Friday, 13 December 2019, 2.00 pm
County Hall, Worcester

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Find out more online:
www.worcestershire.gov.uk

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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
Friday, 13 December 2019, 2.00 pm, County Hall, Worcester

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

Coopted Members

Mr V Allison	Employer Representative
Ms T Fagan	Herefordshire Council
Mr J Price	Employee Representative

Agenda

Item No	Subject	Page No
1	**Named Substitutes**	
2	**Apologies/Declarations of Interest**	
3	**Public Participation** *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 12 December 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** To confirm the Minutes of the meeting held on 16 October 2019 (previously circulated electronically)	
5	**Pension Board and Pension Investment Sub-Committee Minutes**	1 - 2
6	**Actuarial Valuation and final Pension Fund Strategy Statement**	3 - 70
7	**Strategic Asset Allocation Review**	71 - 118
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All the above reports and supporting information can be accessed via the Council's website

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AGENDA ITEM 5

PENSIONS COMMITTEE
13 DECEMBER 2019

PENSION BOARD AND PENSION INVESTMENT SUB-COMMITTEE MINUTES

Recommendation

1. **The Committee is asked to note the Minutes of the Pension Investment Sub-Committee**

2. As set out in the Terms of Reference of the Pension Investment Sub Committee, all decisions taken and recommendations will be reported back to the next available ordinary meeting of the Pensions Committee in the form of the minutes of the ISC. A link to its Minutes on the Council's web site is set out below.

3. The Pensions Board has requested that their deliberations be reported to the Committee and a link to its Minutes on the Council's web site is also set out below.

4. The relevant Minutes for this meeting relate to the Pensions Investment Sub-Committee meeting on 14 November 2019. There has not been a meeting of the Pension Board since the last Committee meeting.

Supporting Information

Links to the Pension Board and Pensions Investment Sub-Committee Minutes can be found below:
http://worcestershire.moderngov.co.uk/ieListMeetings.aspx?CId=395&Year=0
http://worcestershire.moderngov.co.uk/ieListMeetings.aspx?CId=532&Year=0

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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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AGENDA ITEM 6

PENSIONS COMMITTEE
13 DECEMBER 2019

ACTUARIAL VALUATION AND FINAL PENSION FUND STRATEGY STATEMENT

Recommendation

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

   a) **the results of the Actuarial Valuation (Appendix 1) are noted by the Committee;**

   b) **the Funding Strategy Statement (Appendix 2) is approved by the Committee and any further operational changes are delegated to Fund officers with an update provided to the March Pensions Committee; and**

   c) **The points raised (Appendix 3) regarding the specific questions asked on the Funding Strategy Statement be considered and noted**

Background

2. Every three years, in line with legislation, the Fund Actuary, Mercer, carries out a full Actuarial Valuation of the Fund to calculate how much the employers in the Scheme need to contribute going forward to ensure that its liabilities, the pensions due to current and future pensioners, will be paid as they fall due.

3. The purpose of the Funding Strategy Statement ("FSS") is to set out a clear and transparent funding strategy that will identify how each Fund employer's pension liabilities are to be met going forward.

4. The draft Funding Strategy Statement was agreed at Committee on the 16 October 2019 and sent to Employers for consultation on the 29 October 2019 with an initial deadline of the 22 November 2019. However, this was extended to the 4 December 2019 as some Employers did not receive their initial valuation results until the 19 November 2019. Details of the outcome of this consultation is detailed further on in this report.

Provisional Actuarial Valuation

5. The results at a total Fund level are shown in Appendix 1 to this report. The Fund's funding level has increased from 75% funded at 31 March 2016 to 91.3% at 31 March 2019. Total employer contributions are expected to decrease for 2020/21 below those planned following the 2016 Actuarial Valuation by £15.0m (£82m compared to £97m) based on the initial base option.

6. Committee are asked to note that the actual whole fund contributions to be received will ultimately depend on the employer contributions agreed with each individual employer.

7. This will depend upon the key funding strategy parameters, such as open / closed to new entrants, deficit recovery period, short term pay allowance, investment pot as well as choices made around the timing of contributions (e.g. selected prepayments or phasing of contribution increases). If the major employers opt for 3-year prepayments this would have a notable impact on the timing of the cashflows.

8. Members may recall the McCloud case and the judgement in the summer regarding retirement ages. Mercers have provided an estimate of the potential impact for all Employers separately and Employers were asked via the consultation as to whether they wanted to include this as part of their annual contributions or set a provision aside to meet this once the actual impact is known.

Funding Strategy Statement for employer consultation

9. The Funding Strategy Statement is attached as Appendix 2 to this report. The key points of the statement are shown below:

- The target recovery period for the Fund as a whole is 15 years at this valuation which is 3 years shorter than the corresponding recovery period from the previous valuation. Subject to affordability and other considerations, individual employer recovery periods would also be expected to reduce by 3 years at this valuation. **(Page 2 of the FSS)**

- A Key change to the method of valuing the Fund's liabilities is the valuation of the real return over CPI inflation for determining the past service liabilities is 1.65% (2.15% in 2016) per annum and for determining the future service ("Primary") contribution rates is 2.25% (2.75% in 2016) per annum. CPI inflation has been assumed at 2.4% over the review period making the nominal total discount rate / investment return target of 4.05% p.a. for past service and 4.65% p.a. for future service as at 31 March 2019 (**Page 4 of FSS)**

- As the Committee are aware, the remedy for McCloud is not yet known. However, guidance from the Scheme Advisory Board is for Funds to consider their policy in relation to the costs that could emerge in conjunction with their Actuary. As you will see from the attached, the FSS has been drafted to confirm the relevant estimated costs have been quantified and notified to employers. Employers will then have the choice to include these estimated costs over 2020/23 as part of their certified contributions or to make allowance within their budgets and potentially make backdated contributions if the remedy is known before the next valuation. **(Page 3 of FSS)**

- Investment 'pots' – the narrative assumes that the Fund has implemented alternative investment strategies with differential levels of investment risk with effect from 1 April 2020. The aim is to provide greater control over employer's exposure to investment risk **(Page 20 of FSS)**

10. The Committee is asked to note that the FSS is not expected to change fundamentally in between now and when the actuarial valuation is signed off by the actuary in March. There are a few areas where enabling wording has been included for anticipated changes to the LGPS Regulations following consultation with the key stakeholders. These may need to removed, if the amendment Regulations are not laid ahead of the valuation sign off date and reinstated at a future FSS review. The Committee is requested to delegate any further amendments to officers for finalisation. Any changes to the FSS will be reported back to Committee in March 2020 for completeness.

Employer Consultation

11. The provisional individual employer funding results and proposed employer contribution rates for 2020/2021 to 2022/2023 were discussed at the Employer Administration Forum on the 14 October 2019. A presentation from Mercers covered the assumptions used in and the results of the actuarial valuation as at 31 March 2019. Initial meetings were also held with the County Council and District Councils early September 2019.

12. All employers were offered the opportunity to meet up with Mercers, the Funds actuarial advisors to discuss further their results.

13. Employers were also consulted on the specific risk management / contribution rate stabilisation proposals for introducing different investment approaches for employers with similar characteristics instead of continuing with one investment approach for all our employers. The idea being to place employers into potentially one of three to four 'pots' dependent on the perceived Fund risk and resultant investment strategy required.

14. The consultation on the draft FSS was sent to Employers on 21 October and were asked to respond by Friday, 22 November 2019. However, this was extended as per paragraph 4 above. There were 13 formal responses received which is just under 7% of our employers. Appendix 3 provides a summary of the specific questions and responses that were received. A summary is provided below: -

a) What prepayment options should be available e.g. 100% (deficit repayment) / 90% (future service contributions) annually in advance; all 3 years 100% / 90% in advance; first two years 100% / 90% in advance; etc?

   Employers who could afford to prepay were in favour of the differing options being proposed

b) When you think the investment pots should be made available; which investment pot you think might be appropriate for you; whether we should introduce other investment pots and what any other pots should look like? (Even if you do not believe this flexibility will be appropriate for you at the 2019 valuation, we would appreciate your comments in relation to this framework being available for use at a future valuation);

   Most Employers were in favour of exploring and potentially implementing the different risk investment pots

c) Whether we should offer employers with proven short term LGPS affordability problems the option to phase in the increases to their future service % contributions or a longer deficit recovery period? NB if an employer goes bust, other employers must pick up the bill for making good on that employer's pension promises;

Most Employers agreed that such employers should be offered this option subject to their longer-term covenant strength and / or there is a guarantor in place. It was also highlighted that this should be done on exception and subject to review.

d) Whether you plan to make a provision in your contributions for the potential impact of McCloud to give yourself budgeting certainty for the next 3 years? NB the current remedy for the McCloud judgment and the timing of this remedy is unknown. However, employers making a provision at the 2019 valuation by paying the higher suggested McCloud contributions will not have their contributions adjusted before 2023 / 2024, but those choosing to wait for the McCloud remedy to be identified exactly will be asked to pay whatever that turns out to be going forward and to make good on that on a 'backdated to 1 April 2020' basis;

There was a mixed response, but most Employers agreed with either contributing for McCloud as part of their proposed contribution rates or make a specific provision in their accounts. A couple of Employers highlighted that they may not be making a provision and follow up discussions with these Employers will be made by the Fund as they will have a legal duty to comply with the financial outcome of the case.

e) Whether you feel the real pay assumption of CPI + 1.5% p.a. is appropriate? NB this assumption is an average long-term assumption over the total future working lifetime of the active membership of the Fund and should not be considered against any short term budgeted pay restraint; and

There was a mixed response. Some Employers felt that this was realistic, some possibly too high and others had no comment

f) Whether you might be interested in ill health liability insurance: under this (the exact terms would be provided once an analysis of our members has been completed by the insurer) you would pay lower % future service contributions to the pension fund but also pay an additional say 3% contributions which would not be invested in the Fund, but be used to pay the insurance premium. In return for which a contribution would be paid by the insurance company to the pension fund on the occurrence of an ill health retirement. NB For smaller employers, the cost of a single ill-health could have a large impact on your funding position, as an employee aged 30 earning £49,000 who retires on tier 1 ill health is being 'promised' an immediate extra annual pension paid for the rest of their life of (49,000 ÷ 49 * (years between State Pension age of 68 less 30)) = £38,000 p.a. that could be expected to be paid for 50 years (until the employee dies at 80) making a total extra pension paid out of £1,900,000.

4 Employers were interested in this

15. These have been considered and it is considered that although there is a need to clarify some areas with Employers, there are no changes required to the draft FSS that was provided to Employers in October and November 2019. Therefore, the final proposed actuarial valuation and FSS is attached as Appendix 2.

Contact Points

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Supporting Information

- Actuarial Valuation Results (Appendix 1)
- Funding Strategy Statement (Appendix 2)
- Key points raised (Appendix 3) regarding the specific questions asked on the Funding Strategy 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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PRELIMINARY RESULTS

2019 WHOLE FUND RESULTS & SENSITIVITIES – CURRENT BENEFITS

	2016 Valuation	31 March 2019	
		Base Results	Base Results reducing Discount Rate by 0.25% p.a.
Assets	£1,952m	£2,795m	£2,795m
Liabilities	£2,606m	£3,062m	£3,196m
Surplus / Deficit	-£654m	-£267m	-£401m
Funding Level	74.9%	91.3%	87.5%
Future Service Rate (% of pay)	15.3%	17.3%	18.7%
Deficit Recovery Period	18 years	15 years	15 years
Real Discount Rate (Past)	2.15% p.a.	1.65% p.a.	1.40% p.a.
Real Discount Rate (Future)	2.75% p.a.	2.25% p.a.	2.00% p.a.
Short Term Pay	2016 Valuation (4 years at 1% p.a.)	2% p.a. for 4 years	2% p.a. for 4 years
Life Expectancy Assumption	CMI 2015 1.5%	CMI 2018 1.75%	CMI 2018 1.75%

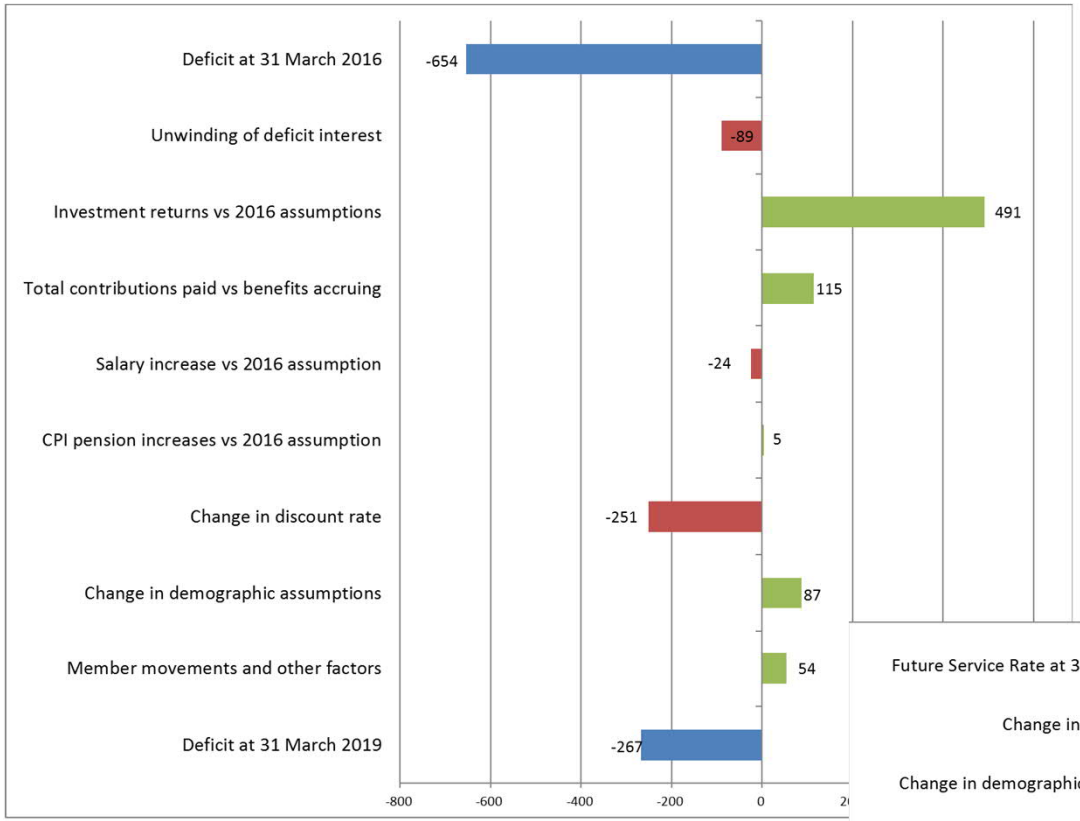
PRELIMINARY RESULTS

2019 WHOLE FUND RESULTS & SENSITIVITIES – CURRENT BENEFITS

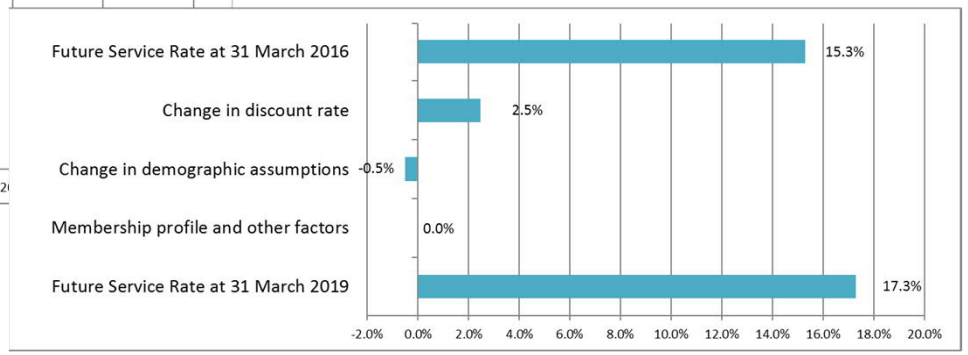
	2016 Valuation	31 March 2019	
		Base Results	Base Results reducing Discount Rate by 0.25% p.a.
Payroll (2020/21 estimate)	£380m	£377m	£377m
Future Service Rate (% of pay)	15.3%	17.3%	18.7%
Surplus / Deficit	-£654m	-£267m	-£401m
2020/21 Future Service Amount	£58m	£65m	£70m
2021/22 Future Service Amount	£60m	£67m	£72m
2022/23 Future Service Amount	£63m	£68m	£73m
2020/21 Deficit Recovery Amount	£39m	£17m	£26m
2021/22 Deficit Recovery Amount	£40m	£17m	£27m
2022/23 Deficit Recovery Amount	£41m	£18m	£28m
Total 2020/21 Contributions	£97m	£82m	£96m
Total 2021/22 Contributions	£100m	£84m	£98m
Total 2022/23 Contributions	£104m	£86m	£101m
Total Contributions (3 year)	**£301m**	**£252m**	**£295m**

PRELIMINARY RESULTS
ANALYSIS OF CHANGE SINCE 2016

PAST SERVICE



FUTURE SERVICE



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FUNDING STRATEGY STATEMENT

WORCESTERSHIRE PENSION FUND

[DECEMBER 2019]

Worcestershire County Council

This Funding Strategy Statement has been prepared by Worcestershire County Council (the Administering Authority) to set out the funding strategy for the Worcestershire Pension Fund (the "Fund"), in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

EXECUTIVE SUMMARY

Ensuring that the Worcestershire Pension Fund (the "Fund") has sufficient assets to meet its pension liabilities in the long term is the fiduciary responsibility of the Administering Authority (Worcestershire County Council). The funding strategy adopted by the Worcestershire Pension Fund will be critical in achieving this.

The purpose of this Funding Strategy Statement ("FSS") is to set out a clear and transparent funding strategy that will identify how each Fund employer's pension liabilities are to be met going forward.

The details contained in this Funding Strategy Statement will have a financial and operational impact on all participating employers in the Worcestershire Pension Fund.

It is imperative therefore that each existing or potential employer is aware of the details contained in this statement.

Given this, and in accordance with governing legislation, all interested parties connected with the Worcestershire Pension Fund have been consulted and given opportunity to comment prior to this Funding Strategy Statement being finalised and adopted. This statement takes into consideration all comments and feedback received.

MEETING THE FUND'S SOLVENCY OBJECTIVE

The Administering Authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period. Contributions are set in relation to this objective which means that once 100% solvency is achieved, if assumptions are borne out in practice, there would be sufficient assets to pay all benefits earned up to the valuation date as they fall due.

However, because financial and market conditions/outlook change between valuations, the assumptions used at one valuation may need to be amended at the next to meet the primary objectives. This in turn means that contributions will be subject to change from one valuation to another. This objective is considered on an employer specific level when setting individual contribution rates so each employer has the same fundamental objective in relation to their liabilities.

The general principle adopted by the Fund is that the assumptions used, taken as a whole, will be sufficiently prudent for this objective to be reasonably achieved in the long term at each valuation.

The funding strategy set out in this document has been developed alongside the Fund's investment strategy on an integrated basis taking into account the overall financial and demographic risks inherent in the Fund to meet the objective for all employers over different periods. The funding strategy includes appropriate margins to allow for the possibility of adverse events (e.g. material reduction in investment returns, economic downturn and higher inflation outlook) leading to a worsening of the funding position which would normally lead to volatility of contribution rates at future valuations if these margins were not included. This prudence is

required by the Regulations and guidance issued by professional bodies and Government agencies to assist the Fund in meeting its primary solvency objective. The level of prudence has been quantified by the Actuary to provide protection against future adverse experience in the long term. Individual employer results will also have regard to their covenant strength and the investment strategy applied to the asset shares of those employers.

LONG TERM COST EFFICIENCY

Employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency requires that any funding plan must provide equity between different generations of taxpayers. This means that the contributions must not be set at a level that is likely to give rise to additional costs in the future which fall on later generations of taxpayers or put too high a burden on current taxpayers. The funding parameters and assumptions e.g. deficit recovery period must have regard to this requirement which means a level of prudence is needed. Furthermore, the FSS must have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

When formulating the funding strategy, the Administering Authority has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary's Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the "solvency" of the pension fund and "long term cost efficiency" of the Local Government Pension Scheme (the "LGPS") so far as relating to the Fund.

DEFICIT RECOVERY PLAN AND CONTRIBUTIONS

As the solvency level of the Fund is [91%] at the valuation date (i.e. the assets of the Fund are less than the liabilities), a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall.

Deficit contributions paid to the Fund by each employer will be expressed as £s amounts (flat or increasing year on year) and it is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford given other competing cost pressures. This may result in some flexibility in recovery periods by employer which would be at the sole discretion of the Administering Authority. The recovery periods will be set by the Fund, although employers will be free to select any shorter deficit recovery period if they wish. Employers may also elect to make prepayments of contributions which could result in a cash saving over the valuation certificate period.

The objective is to recover any deficit over a reasonable timeframe, and this will be periodically reviewed. Subject to affordability considerations a key principle will be to maintain the deficit contributions at least at the expected monetary levels from the preceding valuation (including any indexation in these monetary payments over the recovery period). Full details are set out in this FSS.

The target recovery period for the Fund as a whole is [15] years at this valuation which is [3 years shorter] than the corresponding recovery period from the previous valuation. Subject to affordability

and other considerations, individual employer recovery periods would also be expected to [reduce by 3 years] at this valuation. Further detail of the key principals adopted in relation to the deficit recovery period for individual employers is set out in Appendix B.

Where there is a material increase in contributions required at this valuation, in certain circumstances the employer will be able to 'phase in' contributions over a period of up to [3] years in a pattern agreed with the Administering Authority and depending on the affordability of contributions as assessed in the covenant review of an employer. Equally employers will be able to align their contributions changes with their financial year if this does not end on 31 March.

The Government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. Therefore, the Fund has considered its policy in relation to costs that could emerge from the McCloud judgment in line with the guidance from the Scheme Advisory Board in conjunction with the Actuary. Whilst the remedy is not known and may not be known for some time, for the purpose of this valuation, when considering the appropriate contribution provision, we have assumed that the judgment would have the effect of removing the current age criteria applied to the underpin implemented in 2014 for the LGPS. This underpin therefore would apply to all active members as at 1 April 2012. The relevant estimated costs have been quantified and notified to employers on this basis but also highlighting that the final costs maybe significantly different. Employers will be able to choose to include these estimated costs over 2020/23 in their certified contributions. Alternatively, they will need to make allowance within their budgets and note that backdated contributions could be payable if the remedy is known before the next valuation.

ACTUARIAL ASSUMPTIONS

The actuarial assumptions used for assessing the funding position of the Fund and the individual employers, the "Primary" contribution rate, and any contribution variations due to underlying surpluses or deficits (i.e. the "Secondary" rate) are set out in Appendix A to this FSS.

The discount rate in excess of CPI inflation (the "real discount rate") has been derived based on the expected return on the Fund's assets based on the long term strategy set out in its Investment Strategy Statement (ISS). When assessing the appropriate prudent discount rate, consideration has been given to the level of expected asset returns in excess of CPI inflation (i.e. the rate at which the benefits in the LGPS generally increase each year).

The assumption for the long term expected future real returns has fallen since the last valuation. This is principally due to a combination of expectations of the returns on the Fund's assets and the level of inflation in the long term. Also, as the Fund has implemented a number of risk management strategies since the last valuation, the expected volatility of returns has fallen i.e. provides more certainty to return outcomes. This is also taken into account by the Actuary when proposing the assumptions and at this valuation means that the level of prudence has been reduced. The assumption has therefore been adjusted so that in the Actuary's opinion, when allowing for the resultant employer contributions emerging from the valuation, the Fund can reasonably be expected to meet the solvency and long term cost efficiency objectives.

Taking into account the above the Fund Actuary is proposing that the long term real return over CPI inflation assumptions for determining the past service liabilities should be [1.65]% per annum and [2.25]% per annum assumption for determining the future service ("primary") contribution rate. This compares to [2.15]% per annum and [2.75]% per annum respectively at the last valuation.

The Fund has implemented a choice of "investment" pots to offer to employers which exhibit lower investment risk than the current whole fund strategy with effect from [1 April 2020]. If an employer is deemed to have a weaker covenant than others in the Fund, or it would like to target a lower risk strategy, the Administering Authority has the discretion to move that employer (typically following discussions with the employer) into a different investment strategy to protect the Fund as a whole.
If an employer is deemed to have a weaker covenant than others in the Fund, is planning to exit the Fund or would like to target a lower risk strategy, the Administering Authority has the discretion to move that employer (typically following discussions with the employer) into another strategy to protect the Fund as a whole. The current overall Fund investment strategy (as set out in the Investment Strategy Statement) will be known as the "higher risk investment strategy".
The investment strategy for each of the investment pots will be reviewed, following each actuarial valuation, as a minimum. The discount rate assumption used for employers' liabilities who fall into each category is linked directly to the relevant pot's underlying assets allowing for the underlying level of risk associated.

The demographic assumptions are based on the Fund Actuary's bespoke analysis for the Fund, also taking into account the experience of the wider LGPS where relevant.

EMPLOYER ASSET SHARES

The Fund is a multi-employer pension fund that is not formally unitised and so individual employer asset shares are calculated at each actuarial valuation. This means it is necessary to make some approximations in the timing of cashflows and allocation of investment returns when deriving each employer's asset share.

At each review, cashflows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation. The investment return credited will depend on which investment pot the employers' assets are in.
Other adjustments are also made on account of the funding positions of orphan bodies which fall to be met by all other active employers in the Fund. In addition, the asset shares may be restated for changes in data or other policies.

FUND POLICIES

In addition to the information/approaches required by overarching guidance and regulation, this statement also summarises the Fund's practice and policies in a number of key areas:

1. Covenant assessment and monitoring

An employer's financial covenant underpins its legal obligation and crucially the ability to meet its financial responsibilities to the Fund now and in the future. The strength of covenant to the Fund effectively underwrites the risks to which the Fund is exposed. These risks include underfunding, longevity, investment and market forces.

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital to the overall risk management and governance of the Fund. The employers' covenants will be assessed and monitored objectively in a proportionate manner, and an employer's ability to meet their obligations in the short and long term will be considered when determining its funding strategy.

After the valuation, the Fund will continue to monitor employers' covenants in conjunction with their funding positions over the inter-valuation period. This will enable the Fund to anticipate and pre-empt any material issues arising and thus adopt a proactive approach in partnership with the employer. More details are provided in Appendix D to this statement.

2. Admitting employers to the Fund

Various types of employers are permitted to join the LGPS under certain circumstances, and the conditions upon which their entry to the Fund is based and the approach taken is set out in Appendix C. Examples of new employers include:

- Fund Employers
- Mandatory Scheme Employers - for example new academies (see later section)
- Designated bodies - those that are permitted to join if they pass a resolution
- Admission bodies - usually arising as a result of an outsourcing or a transfer to an entity that provides some form of public service and their funding primarily derives from local or central government.
- [Employers may also join the Fund under the 'Deemed Employer' route. Further information on this is set out within **Appendix C**.]

The key objective for the Fund is to only admit employers where the risk to the Fund is mitigated as far as possible. Certain employers may be required to provide a guarantee or alternative security before entry will be allowed, in accordance with the Regulations and Fund policies.

3. New academy conversions and multi-academy trusts

Current Fund policy regarding the treatment of schools when converting to academy status is for the new academy to inherit the school's share of the historic local authority deficit prior to its conversion. This deficit is calculated as the capitalised deficit funding contributions (based on the local authority deficit recovery period) the school would have made to the Fund had it not converted to academy status, subject to a minimum asset share of nil. In cases where numerous academies which participate in the Fund are in the same multi-academy trust, the Fund is willing to allow a combined funding position and average contribution requirements to apply.

4. Termination policy for employers exiting the Fund

When an employer ceases to participate within the Fund, it becomes an exiting employer under the Regulations. The Fund is then required to obtain an actuarial valuation of that employer's

liabilities in respect of the benefits of the exiting employer's current and former employees, along with a termination contribution certificate.

Where there is no guarantor who would subsume the liabilities of the exiting employer, the Fund's policy is that a discount rate linked to government bond yields and a more prudent longevity assumption is used for assessing liabilities on termination. Any exit payments due should be paid immediately although instalment plans will be considered by the Administering Authority on a case by case basis.

Any exit credits (surplus assets over liabilities) will be paid from the Fund to the exiting employer following certification by the Actuary. The Administering Authority also reserves the right to modify this approach on a case by case basis if circumstances warrant it.

Where there is a **guarantor** who would subsume the assets and liabilities of the outgoing employer, the policy is that any deficit or surplus would normally be subsumed into the guarantor and taken into account at the following valuation. This is subject to agreement from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor, in particular any 'risk-sharing' agreements that may exist.

[An employer may continue to participate in the Fund with no contributing members and utilise the "deferred debt" arrangements at the sole discretion of the Administering Authority which will be subject to a satisfactory covenant review on an ongoing basis. In this circumstance they will be treated as per any other participating employer in relation to overall funding strategy (including potentially requiring a final exit payment at some point) allowing for the covenant.]

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1 INTRODUCTION

The Local Government Pension Scheme Regulations 2013 ("the 2013 Regulations") and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 ("the 2014 Transitional Regulations") and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (all as amended) (collectively; "the Regulations") provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Worcestershire Pension Fund (the "Fund"), the Administering Authority will prepare and publish their funding strategy;
- In preparing the FSS, the Administering Authority must have regard to:
  - the guidance issued by CIPFA for this purpose; and
  - the Investment Strategy Statement (ISS) for the Fund published under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (as amended);
- The FSS must be revised and published whenever there is a material change in either the policy set out in the FSS or the ISS.

BENEFITS

The benefits provided by the Fund are specified in the governing legislation contained in the Regulations referred to above. Benefits payable under the Fund are guaranteed by statute and thereby the pensions promise is secure for members. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time facilitating scrutiny and accountability through improved transparency and disclosure.

The Fund is a defined benefit arrangement with principally final salary related benefits from contributing members up to 1 April 2014 and Career Averaged Revalued Earnings ("CARE") benefits earned thereafter. There is also a "50:50 Scheme Option", where members can elect to accrue 50% of the full Fund benefits in relation to the member only and pay 50% of the normal member contribution.

EMPLOYER CONTRIBUTIONS

The required levels of employee contributions are specified in the Regulations. Employer contributions are determined in accordance with the Regulations (which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate specifying the "primary" and "secondary" rate of the employer's contribution).

PRIMARY RATE

The "Primary rate" for an employer is the contribution rate required to meet the cost of the future accrual of benefits, ignoring any past service surplus or deficit, but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer's covenant and including ancillary death in service and ill health benefits (subject to any external insurance arrangement) together with administration costs.

The Primary rate for the whole fund is the weighted average (by payroll) of the individual employers' Primary rates.

SECONDARY RATE

The "Secondary rate" is an adjustment to the Primary rate to reflect any past service deficit or surplus, to arrive at the total rate of contribution each employer is required to pay. The Secondary rate may be expressed as a percentage adjustment to the Primary rate, and/or a cash adjustment in each of the [three] years beginning 1 April in the year following that in which the valuation date falls.

The Secondary rate is specified in the rates and adjustments certificate.

For any employer, the rate they are actually required to pay is the sum of the Primary and Secondary rates.

Secondary rates for the whole fund in each of the [three years] shall also be disclosed. These will be the calculated weighted average based on the whole fund payroll in respect of percentage rates and the total amount in respect of cash adjustments.

2
PURPOSE OF FSS IN POLICY TERMS

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the actuary.

The Administering Authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due.

The purpose of this Funding Strategy Statement is therefore:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward by taking a prudent longer-term view of funding those liabilities;
- to establish contributions at a level to "secure the solvency" of the pension fund and the "long term cost efficiency",
- to have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, including the disparate investment pots, it must remain a single strategy for the Administering Authority to implement and maintain.

3
AIMS AND PURPOSE OF THE FUND

THE AIMS OF THE FUND ARE TO:

- manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due
- enable employer contribution rates to be kept at a reasonable and affordable cost to the taxpayers, scheduled, resolution and admitted bodies, while achieving and maintaining fund solvency and long term cost efficiency, which should be assessed in light of the profile of the Fund now and in the future due to sector changes
- maximise the returns from investments within reasonable risk parameters taking into account the above aims.

THE PURPOSE OF THE FUND IS TO:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of Fund benefits, transfer values, exit credits, costs, charges and expenses as defined in the Regulations.

4
RESPONSIBILITIES OF THE KEY PARTIES

The efficient and effective management of the Fund can only be achieved if all parties exercise their statutory duties and responsibilities conscientiously and diligently. The key parties for the purposes of the FSS are the Administering Authority (and, in particular the Pensions Committee, the individual employers and the Fund Actuary and details of their roles are set out below. Other parties required to play their part in the fund management process are bankers, custodians, investment managers, auditors and legal, investment and governance advisors, along with the Local Pensions Board created under the Public Service Pensions Act 2013.

KEY PARTIES TO THE FSS

The **Administering Authority** should:

- operate the pension fund
- collect employer and employee contributions, investment income and other amounts due to the pension fund as stipulated in the Regulations
- pay from the pension fund the relevant entitlements as stipulated in the Regulations
- invest surplus monies in accordance with the Regulations
- ensure that cash is available to meet liabilities as and when they fall due
- take measures as set out in the Regulations to safeguard the fund against the consequences of employer default
- manage the valuation process in consultation with the Fund's actuary
- prepare and maintain a FSS and an ISS, both after proper consultation with interested parties, and
- monitor all aspects of the Fund's performance and funding, amending the FSS/ISS as necessary
- effectively manage any potential conflicts of interest arising from its dual role as both fund administrator and a Fund employer, and
- establish, support and monitor a Local Pension Board (LPB) as required by the Public Service Pensions Act 2013, the Regulations and the Pensions Regulator's relevant Code of Practice.

The **Individual Employer** should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations)
- pay all contributions, including their own as determined by the actuary, promptly by the due date
- develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain
- have regard to the Pensions Regulator's focus on data quality and comply with any requirement set by the Administering Authority in this context
- notify the Administering Authority promptly of any changes to membership which may affect future funding

- understand the pensions impacts of any changes to their organisational structure and service delivery model, and
- understand that the quality of the data provided to the Fund will directly impact on the assessment of the liabilities and contributions. In particular, any deficiencies in the data would normally result in the employer paying higher contributions than otherwise would be the case if the data was of high quality.

The **Fund Actuary** should:

- prepare valuations including the setting of employers' contribution rates at a level to ensure fund solvency after agreeing assumptions with the Administering Authority and having regard to their FSS and the Regulations
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as pension strain costs, ill health retirement costs, etc.
- provide advice and valuations on the termination of admission agreements including in relation to exit credit payments
- provide advice to the Administering Authority on bonds and other forms of security against the financial effect on the Fund of employer default
- assist the Administering Authority in assessing whether employer contributions need to be revised between valuations as required by the Regulations
- advise on funding strategy, the preparation of the FSS and the inter-relationship between the FSS and the ISS, and
- ensure the Administering Authority is aware of any professional guidance or other professional requirements which may be of relevance to the Fund Actuary's role in advising the Fund.

5
SOLVENCY FUNDING TARGET

Securing the “solvency” and “long term cost efficiency” is a regulatory requirement. To meet these requirements, the Administering Authority’s long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the “funding target”) assessed on an ongoing past service basis including allowance for projected final pay where appropriate. In the long term, an employer’s total contribution rate would ultimately revert to its Primary rate of contribution.

SOLVENCY AND LONG TERM EFFICIENCY

Each employer’s contributions are set at such a level to achieve full solvency in a reasonable timeframe. Solvency is defined as a level where the Fund’s liabilities i.e. benefit payments can be reasonably met as they arise.

Employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency implies that contributions must not be set at a level that is likely to give rise to additional costs in the future. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the appropriate time.

When formulating the funding strategy, the Administering Authority has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary’s Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the “solvency” of the pension fund and “long term cost efficiency" of the LGPS so far as relating to the Fund.

DETERMINATION OF THE SOLVENCY FUNDING TARGET AND DEFICIT RECOVERY PLAN

The principal method and assumptions to be used in the calculation of the funding target are set out in **Appendix A**. The Employer Deficit Recovery Plans are set out in **Appendix B**.

Underlying these assumptions are the following two tenets:

- that the Fund is expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

This allows the Fund to take a longer term view when assessing the contribution requirements for certain employers.

In considering this the Administering Authority, based on the advice of the Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful potentially taking into account any changes in funding after the valuation date up to the finalisation of the valuation by 31 March 2020 at the latest.

As part of each valuation separate employer contribution rates are assessed by the Fund Actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer, following a principle of no cross-subsidy between the distinct employers and employer groups in the Fund.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates arising from the 2019 actuarial valuation:

Individual employer contributions will be expressed and certified as two separate elements:

- the **Primary rate**: a percentage of pensionable payroll in respect of the cost of the future accrual of benefits
- the **Secondary rate**: a schedule of lump sum monetary amounts over 2020/23 in respect of an employer's surplus or deficit (or as a percentage rate for the Town and Parish Council's group and any other employer at the Administering Authority's ultimate discretion)

DEFICIT RECOVERY PLAN

It is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford based on the Administering Authority's view of the employer's covenant and risk to the Fund.

Recovery periods will be set by the Fund on a consistent basis across employer categories where possible and communicated as part of the discussions with employers. This will determine the minimum contribution requirement and employers will be free to select any shorter deficit recovery period and higher contributions if they wish, including the option of prepaying the deficit contributions in one lump sum either on an annual basis or a one-off payment. This will be reflected in the monetary amount requested via a reduction in overall deficit contributions payable. The Administering Authority does retain ultimate discretion in applying these principles for individual employers on grounds of affordability and covenant strength.

The key principles when considering deficit recovery are as follows:

- The Fund will consider whether it is appropriate for deficit contribution reductions to apply compared to the existing funding plan (allowing for indexation where applicable) where deficits remain. This will be based on assessment of the employer covenant (including affordability of the existing funding plan) and any other relevant factors.
- Subject to consideration of affordability, as a general rule the deficit recovery period will reduce by at least 3 years for employers at this valuation when compared to the preceding valuation. This is to target full solvency over a similar (or shorter) time horizon. This is to maintain (as far as possible) equity between different generations of taxpayers and to protect the Fund against the potential for an unrecoverable deficit. The deficit recovery period will be set to at least cover the expected interest costs (actual interest costs will vary in line with investment performance) on the deficit.

- Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. Subject to affordability considerations and other factors, a bespoke period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan in Appendix B). The average recovery period adopted by all employers will be set out within the Actuary's report. Employers will be notified of their individual deficit recovery period as part of the provision of their individual valuation results. Where increases (or decreases) in employer contributions are required from 1 April 2020, following completion of the 2019 actuarial valuation, at the sole discretion of the Administering Authority the increase (or decrease) from the rates of contribution payable in the year 2020/21 may be implemented in steps, over a maximum of 3 years, depending on affordability of contributions as determined by the administering authority. This will be notified to employers as part of the valuation process. However, where a surplus exists or where there has been a reduction in contributions paid in respect of an employer's deficit at the valuation, the Fund would not consider it appropriate for any increase in contributions paid in respect of future accrual of benefits to be implemented in steps.

- As part of the process of agreeing funding plans with individual employers, the Administering Authority will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities.

- It is acknowledged by the Administering Authority that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Administering Authority therefore would be willing to use its discretion to accept an evidence-based affordable level of contributions for the organisation for the three years 2020/2023. Any application of this option is at the ultimate discretion of the Fund officers and Section 151 officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.

- For those bodies identified as having a weaker covenant, the Administering Authority will need to balance the level of risk plus the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans.

- Notwithstanding the above principles, the Administering Authority, in consultation with the actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

- On the cessation of an employer's participation in the Fund, in accordance with the Regulations, the Fund Actuary will be asked to make a termination assessment. In such circumstances:

The policy for employers who have a guarantor participating in the Fund:

The residual assets and liabilities and hence any surplus or deficit will normally transfer back to the guarantor but in circumstances where an exiting employer is expected to still be responsible for the termination position, an exit payment/exit credit may be payable from/to the exiting employer.

This is subject to agreement from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor, in particular any 'risk-sharing' agreements that may exist. If all parties do not agree, then the surplus/deficit will be paid directly to/by the exiting employer following cessation (despite any other agreements that may be in place).

The policy for employers who do not have a guarantor participating in the Fund:

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 3 months of completion of the cessation assessment by the Actuary). For the avoidance of doubt this will include an appropriate provision for potential costs of the McCloud case remedy as per the approach set out in this FSS.

- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

Where an employer with no guarantor leaves the Fund and leaves liabilities with the Fund which the Fund must meet without recourse to that employer, the valuation of the termination payment will be calculated using a discount rate based on a minimum risk investment strategy and a more prudent life expectancy assumption. Further details are set out in the Termination Policy in Appendix C.

The Administering Authority can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary and, for example, may adjust any exit payment or exit credit to take into account any risk sharing arrangements which exist between the exiting employer and other Fund employers.

Subject to sufficient financial covenant and at the sole discretion of the Administering Authority an employer may continue to participate in the Fund with no contributing members under the Deferred Debt arrangement.

The termination policy [(including Deferred Debt arrangements)] is set out in **Appendix C**.

FUNDING FOR NON-ILL HEALTH EARLY RETIREMENT COSTS

Employers are required to meet all costs of early retirement strain by immediate capital payments into the Fund, or in certain circumstances by agreement with the Fund, through instalments over a period not exceeding 3 years or if less the remaining period of the body's membership of the Fund.

FUNDING FOR ILL HEALTH RETIREMENT COSTS

Should a member retire on ill health grounds, this will normally result in a funding strain for that employer (i.e. increased liability). The size of any funding strain will depend on how the cost of that ill health retirement compares with the expected cost built in the actuarial assumptions for that employer. The actual cost will also depend on the level of any benefit enhancements awarded (which depend on the circumstances of the ill health retirement) and also how early the benefits are brought into payment.

- the “primary rate” payable over 2020/23 includes an allowance for ill-health retirement costs (alongside those for voluntary early retirements). Where an ill-health retirement occurs no additional contributions will be due immediately from the employer although any funding strain or profit will emerge following the subsequent actuarial valuation through increased/reduced deficit, depending on the difference in the funding cost of the ill health retirement (on the actuarial valuation assumptions) and the expected cost built into the “primary rate”.

6

LINK TO INVESTMENT POLICY AND THE INVESTMENT STRATEGY STATEMENT (ISS)

The results of the 2019 valuation show the liabilities to be [91%] covered by the current assets, with the funding deficit of [9%] being covered by future deficit contributions.

In assessing the value of the Fund's liabilities in the valuation, allowance has been made for growth asset out-performance as described below, taking into account the investment strategy adopted by the Fund, as set out in the ISS.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which represents the "minimum risk" investment position which would deliver a very high certainty of real returns above assumed CPI inflation. Such a portfolio would consist of a mixture of long-term index-linked, fixed interest gilts and possible swaps.

Investment of the Fund's assets in line with this portfolio would minimise fluctuations in the Fund's funding position between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out this valuation it would not be appropriate to make any allowance for growth assets out-performance or any adjustment to market implied inflation assumption due to supply/demand distortions in the bond markets. This would result in a real return versus CPI inflation of nil per annum at the valuation date. On this basis of assessment, the assessed value of the Fund's liabilities at the valuation would have been significantly higher, resulting in a funding level of [67%]. This is a measure of the level of reliance on future investment returns i.e. level of investment risk being taken.

Departure from a minimum risk investment strategy, in particular to include growth assets such as equities, gives a better prospect that the assets will, over time, deliver returns in excess of CPI inflation and reduce the contribution requirements. The target solvency position of having sufficient assets to meet the Fund's pension obligations might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The overall strategic asset allocation is set out in the Investment Strategy Statement (ISS).

Based on the investment strategy in the ISS and the Actuary's assessment of the return expectations for each asset class, this leads to an overall best estimate average expected return of [3.0]% per annum in excess of CPI inflation as at the valuation date. For the purposes of setting funding strategy however, the Administering Authority believes that it is appropriate to take a margin for prudence on these return expectations. and this is expected under the Regulations and guidance.

A measure of overall prudence to protect against adverse experience in the future is to consider the funding level if it was assessed on a "best estimate" basis for all the principal assumptions (mainly the investment return and life expectancy). The actuary has assessed this funding level as [91%]. This level of prudence is built in to allow the Fund to address adverse events whilst maintain stability (within reasonable parameters) in employer contributions where appropriate. This margin however, has been

reduced to take account of the risk management strategies implemented to reduce the volatility of returns within the investment strategy

RISK MANAGEMENT STRATEGY

In the context of managing various aspects of the Fund's financial risks, the Administering Authority has implemented a number of risk management techniques. The principal aim of these risk management techniques is to effectively look to provide more certainty of contribution outcomes within reasonable parameters.

In particular:

- Equity Protection - the Fund has implemented protection against potential falls in the equity markets via the use of derivatives. The aim of the protection is to provide further stability (or even a reduction) in employer deficit contributions (all other things equal) in the event of a significant equity market fall (although it is recognised that it will not protect the Fund in totality). Further information in relation to the equity protection arrangement is available within the Fund's Investment Strategy Statement and Committee papers.

- Investment 'pots' – the Fund has implemented alternative investment strategies with differential levels of investment risk with effect from 1 April 2020. The aim is to provide greater control over employers' exposure to investment risk (see further information below).

INVESTMENT POTS

The Fund has implemented a choice of "investment pots" for employers with effect from 1 April 2020. These will be called:

- Higher risk pot
- Medium risk pot
- Lower risk pot

The current Fund investment strategy will apply to the "higher risk pot". The "medium risk pot" and "lower risk pot" will give employers the option to reduce the level of investment risk that they wish to take, particularly for those employers that are considering leaving the Fund. In addition, any orphaned liabilities once an employer exits the Fund will generally be moved into the lower risk pot as these liabilities have no sponsoring employer and are ultimately underwritten by all employers within the Fund.

The strategic allocation for the Fund and the pots is set out in the Investment Strategy Statement.

The choice of pot will be reflected in the relevant employer's asset share, funding basis and contribution requirements.

If, based on the assessments carried out by the Administering Authority, the employer is deemed to have a weaker covenant than other employers in the Fund or alternatively is expected to exit in the near future, the Administering Authority reserves the right to move the employer (typically following discussions with the employer) into the medium or lower risk investment strategy to protect the Fund as a whole.

7
IDENTIFICATION OF RISKS AND COUNTER-MEASURES

The funding of defined benefits is by its nature uncertain. Funding of the Fund is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the Fund Actuary that the greatest risk to the funding level is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from that assumed in the long term. The Actuary's formal valuation report includes quantification of some of the major risk factors. The risk mitigations are set out in the Fund's separate risk register which is included in the Committee papers.

FINANCIAL

The financial risks are as follows:-

- Investment markets fail to perform in line with expectations
- Protection and risk management policies fail to perform in line with expectations
- Market outlook moves at variance with assumptions
- Investment fund managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- Future underperformance arising as a result of participating in the larger asset pooling vehicle, and
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements.

Any increase in employer contribution rates (as a result of these risks) may in turn impact on the service delivery of that employer and their financial position.

In practice the extent to which these risks can be reduced is limited. However, the Fund's asset allocation (including in each separate investment pot) is kept under constant review and the performance of the investment managers is regularly monitored. In addition, the implementation of a risk management framework to manage the key financial risks will help reduce risk over time.

DEMOGRAPHIC

The demographic risks are as follows:-

- Future changes in life expectancy (longevity) cannot be predicted with any certainty
- Potential strains from ill health retirements, over and above what is allowed for in the valuation assumptions (or level of ill-health insurance protection, where relevant)

- Unanticipated acceleration of the maturing of the Fund resulting in materially negative cashflows and shortening of liability durations

Increasing longevity is something which government policies, both national and local, are designed to promote. It does, however, result in a greater liability for pension funds.

Ill health retirements can be costly for employers, particularly small employers where one or two costly ill health retirements can take them well above the "average" implied by the valuation assumptions. Increasingly we are seeing employers mitigate the number of ill health retirements by employing HR / occupational health preventative measures. These in conjunction with ensuring the regulatory procedures in place to ensure that ill-health retirements are properly controlled, can help control exposure to this demographic risk. The Fund's external ill health insurance arrangement will also help to ensure that the eligible employers are not exposed to large deficits due to the ill health retirement of one or more of their members.

Whilst regulatory procedures are in place to ensure that ill-health retirements are properly controlled, employing bodies also need to recognise that unforeseen costs for them will arise in the event that the number of ill-health retirements were to exceed the assumptions made. Early retirements for reasons of redundancy and efficiency do not affect the solvency of the Fund because they are the subject of a direct charge.

Apart from the regulatory procedures in place to ensure that ill-health retirements are properly controlled, **employing bodies should be doing everything in their power to minimise the number of ill-health retirements.**

With regards to increasing maturity (e.g. due to further cuts in workforce and/or restrictions on new employees accessing the Fund), the Administering Authority regularly monitors the Fund's cashflow requirements and considers the impact on the investment strategy.

REGULATORY

The key regulatory risks are as follows:-

- Changes to Regulations, e.g. changes to the benefits package, retirement age, potential new entrants to Fund,
- Changes to national pension requirements and/or HMRC Rules
- Political risk that the guarantee from the Department for Education for academies is removed or modified along with the operational risks as a consequence of the potential for a large increase in the number of academies in the Fund due to Government policy.

Membership of the LGPS is open to all local government staff and should be encouraged as a valuable part of the contract of employment. However, increasing membership does result in higher employer monetary costs.

GOVERNANCE

The Fund has done as much as it believes it reasonably can to enable employing bodies and Fund members (via their representatives on the Local Pension Board) to make their views known to the Fund and to participate in the decision-making process. The previous version of this FSS was consulted on prior to 31 March 2017 with a further consultation taking place following the publication of the Local Government Pension Scheme (Amendment) Regulations 2018 and the introduction of exit credits. The revisions to the FSS have been incorporated into this version and the updated version was finalised following the Committee meeting on [13 December] 2019.

Governance risks are as follows:-

- The quality of membership data deteriorates materially due to breakdown in processes for updating the information resulting in liabilities being under or overstated
- Administering Authority unaware of structural changes in employer's membership (e.g. large fall in employee numbers, large number of retirements) with the result that contribution rates are set at too low a level
- Administering Authority not advised of an employer closing to new entrants, something which would normally require an increase in contribution rates
- An employer ceasing to exist with insufficient funding or adequacy of a bond
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements, and
- Changes in the Committee membership.

For these risks to be minimised much depends on information being supplied to the Administering Authority by the employing bodies. Arrangements are strictly controlled and monitored, but in most cases the employer, rather than the Fund as a whole, bears the risk.

8
MONITORING AND REVIEW

The Administering Authority has taken advice from the Actuary in preparing this Statement, and has consulted with the employers participating in the Fund.

A full review of this Statement will occur no less frequently than every [3] years, to coincide with completion of a full actuarial valuation. Any review will take account of the current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example, if there:

- has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- have been significant changes to the Fund membership, or LGPS benefits e.g. resolution of the McCloud remedy.
- have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy
- have been any significant special contributions paid into the Fund
- has been a change in Regulations or Guidance which materially impacts on the policies within the funding strategy.

When monitoring the funding strategy, if the Administering Authority considers that any action is required, the relevant employing authorities will be contacted. In the case of admitted bodies, there is statutory provision for rates to be amended between valuations and this will be considered in conjunction with the employer affected and any associated guarantor of the employer's liabilities (if relevant).

[REVIEW OF CONTRIBUTIONS

In line with the Regulations, the Administering Authority has the ability to review employer contributions or request a full interim valuation. If considered appropriate, the Fund will carry out an interim valuation or a review of contributions for a specific employer or employer(s), if there:

1. has been a significant change in market conditions so that the funding level has changed by [more than 10% over a period of [y] months / the whole Fund funding level drops below 90%]
2. has been a material change in an employer's covenant assessed in line with the policy in Appendix D
3. the employer has notified the Fund of their intention to exit within the next [x] years. Employers must notify the Fund as soon as they become aware of their planned exit date
4. has been a deviation in the progress of the funding strategy for the employer
5. have been significant changes to the Scheme membership, or LGPS benefits
6. has been a change in employer status
7. have been any significant special contributions paid into the Fund, or
8. have been significant statutory or regulatory changes.

In the normal course of events, contributions will only be reviewed for statutory or tax raising employers as part of a full actuarial valuation (statutory or interim valuation).

Consideration will be given to any cap and collar arrangements when reviewing contribution rates.

In exceptional circumstances, not envisaged in the Funding Strategy Statement, the Fund can apply for a direction from the Secretary of State to carry out an interim valuation. The Secretary of State would also have a power to require interim valuations of the Fund either on representation from funds, scheme employers or of his own motion.

Where the contribution review is triggered by an employer request (e.g. points 2, 3, 4, 5, 6 and 7 above), the costs associated with the review will be included in the assessment of the contributions if deemed appropriate.]

THE MCCLOUD JUDGMENT

The cost management process was set up by HMT, with an additional strand set up by the Scheme Advisory Board (for the LGPS). The aim of this was to control costs for employers and taxpayers via adjustments to benefits and/or employee contributions.

As part of this, it was agreed that employers should bear the costs/risks of external factors such as the discount rate, investment returns and inflation changes, whereas employees should bear the costs/risks of other factors such as wage growth, life expectancy changes, ill health retirement experience and commutation of pension.

The outcomes of the cost management process were expected to be implemented from 1 April 2019, based on data from the 2016 valuations for the LGPS. This has now been put on hold due to age discrimination cases brought in respect of the firefighters and judges schemes, relating to protections provided when the public sector schemes were changed (which was on 1 April 2014 for the LGPS and 1 April 2015 for other Schemes).

The Government have confirmed that this judgment will result in a remedy being required for the LGPS. The Scheme Advisory Board issued guidance **here** which sets out how the McCloud case should be allowed for within the 2019 valuation.

Therefore, the Fund has considered its policy in relation to costs that could emerge from the McCloud judgment in line with the guidance from the Scheme Advisory Board in conjunction with the Actuary. Whilst the remedy is not known and may not be known for some time, for the purpose of this valuation, when considering the appropriate contribution provision, we have assumed that the judgment would have the effect of removing the current age criteria applied to the underpin implemented in 2014 for the LGPS. This underpin therefore would apply to all active members as at 1 April 2012. The relevant estimated costs have been quantified and notified to employers on this basis but also highlighting that the final costs maybe significantly different. Employers will be able to choose to include these estimated costs over 2020/23 in their certified contributions. Alternatively, they will need to make allowance within their budgets and note that backdated contributions could be payable if the remedy is known before the next valuation.

The mechanism to achieve this has been set out in the Actuary's certificate.

APPENDIX A

ACTUARIAL METHOD AND ASSUMPTIONS

METHOD

The actuarial method to be used in the calculation of the solvency funding target is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the Fund on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, alternative methods are adopted, which make advance allowance for the anticipated future ageing and decline of the current closed membership group potentially over the period of the rates and adjustments certificate.

FINANCIAL ASSUMPTIONS – SOLVENCY FUNDING TARGET

Investment return (discount rate)

The discount rate has been derived based on the expected return on the Fund assets based on the long term strategy set out in the Investment Strategy Statement (ISS). It includes appropriate margins for prudence. When assessing the appropriate discount rate consideration has been given to the returns in excess of CPI inflation (as derived below). The discount rate at the valuation date for the higher risk investment pot has been derived based on an assumed return of [1.65]% per annum above CPI inflation, i.e. a total discount rate of [4.05]% per annum. This real return will be reviewed from time to time based on the investment strategy, market outlook and the Fund's overall risk metrics. The discount rate will be reviewed as a matter of course at the time of a formal valuation or a formal employer rate review.

For those employers who are funding on one of the alternative investment pots, the discount rate used will be linked directly to the yields available for the assets within the relevant pot. This will be notified as part of the valuation and set out in the Actuary's report.

Inflation

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Fund's accrued liabilities, but subject to the following two adjustments:

- an allowance for supply/demand distortions in the bond market is incorporated, and
- an adjustment due to retirement pensions being increased annually by the change in the Consumer Prices Index rather than the Retail Prices Index

The overall reduction to RPI inflation at the valuation date is 1.0% per annum.

Salary increases

In relation to benefits earned prior to 1 April 2014, the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase assumption allowance has been made for expected short term pay restraint for some employers as budgeted in their financial plan. The assumption used for an employer will be notified to them separately as part of the discussions but typically will be a minimum of [2%] per annum for the 4 year period to 2023.

Application of bespoke salary increase assumptions as put forward by individual employers will be at the ultimate discretion of the Administering Authority but as a minimum must be reasonable and practical. To the extent that experience differs to the assumption adopted, the effects will emerge at the next actuarial valuation.

Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. some Guaranteed Minimum Pensions where the LGPS is not currently required to provide full indexation). For members in pensionable employment, their CARE benefits are also indexed by CPI although this can be less than zero i.e. a reduction in benefits, whereas for pension increases this cannot be negative, as pensions cannot be reduced.

DEMOGRAPHIC ASSUMPTIONS

Mortality/Life Expectancy

The mortality in retirement assumptions are based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the Fund. The mortality tables used are set out below, with a loading reflecting LGPS experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary. A specific mortality assumption has also been adopted for current members who retire on the grounds of ill health. For all members, it is assumed that the trend in longevity seen over recent time periods (as evidenced in the 2018 CMI analysis) will continue in the longer term and as such, the assumptions build in a level of longevity 'improvement' year on year in the future in line with the CMI 2018 projections and a long term improvement trend of 1.75% per annum.

As an indication of impact, we have set out the life expectancies at age 65 based on the 2019 assumptions:

Membership Category	Male Life Expectancy at 65	Female Life Expectancy at 65
Pensioners	23.1	25.7
Actives aged 45 now	24.6	27.6
Deferreds aged 45 now	23.2	26.4

For example, a male pensioner, currently aged 65, would be expected to live to age 88.1. Whereas a male active member aged 45 would be expected to live until age 89.6. This is a reflection of the expected improvement in life expectancy over the next 20 years in the assumptions above.

The mortality before retirement has also been adjusted based on LGPS wide experience.

Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take a 3/80ths cash sum (available as standard under the pre 1 April 2008 benefit structure). The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up.

Other Demographics

Following an analysis of Fund experience carried out by the Actuary, the incidence of ill health retirements, withdrawal rates and the proportions married/civil partnership assumption remain in line with the assumptions adopted for the last valuation. In addition, no allowance will be made for the future take-up of the 50:50 option. Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the rate for the next [3] years. Other assumptions are as per the last valuation.

Expenses

Expenses are met out of the Fund, in accordance with the Regulations. This is allowed for by adding 0.4% of pensionable pay to the contributions as required from participating employers. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits

The costs of any discretion exercised by an employer in order to enhance benefits for a member through the Fund will be subject to additional contributions from the employer as required by the Regulations as and when the event occurs. As a result, no allowance for such discretionary benefits has been made in the valuation

METHOD AND ASSUMPTIONS USED IN CALCULATING THE COST OF FUTURE ACCRUAL (OR PRIMARY RATE)

The future service liabilities are calculated using the same assumptions as the funding target except that a different financial assumption for the discount rate is used. A critical aspect here is that the Regulations state the desirability of keeping the “Primary Rate” (which is the future service rate) as stable as possible so this needs to be taken into account when setting the assumptions.

As future service contributions are paid in respect of benefits built up in the future, the Primary Rate should take account of the market conditions applying at future dates, not just the date of the valuation and a slightly higher expected return from the investment strategy has been assumed. This is to reflect the future liabilities for which these contributions will be paid have a longer average duration than the past service liabilities as they relate to active members only, and therefore, the longer period for these contributions to be invested.

The financial assumptions in relation to future service (i.e. the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real discount rate of 2.25% per annum above the long term average assumption for consumer price inflation of 2.4% per annum. This leads to a discount rate of [4.65%] per annum.

EMPLOYER ASSET SHARES

The Fund is a multi-employer pension Fund that is not formally unitised and so individual employer asset shares are calculated at each actuarial valuation. This means it is necessary to make some approximations in the timing of cashflows and allocation of investment returns when deriving the employer asset share.

In attributing the overall investment performance obtained on the assets of the Fund to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Fund as a whole (taking account of the respective investment pots) unless agreed otherwise between the employer and the Fund at the sole discretion of the Administering Authority.

At each review, cashflows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation. The investment return credited will depend on which investment pot the employers' assets are in.

Other adjustments are also made on account of the funding positions of orphan bodies which fall to be met by all other active employers in the Fund.

SUMMARY OF KEY WHOLE FUND ASSUMPTIONS USED FOR CALCULATING FUNDING TARGET AND COST OF FUTURE ACCRUAL (THE "PRIMARY RATE") FOR THE 2019 ACTUARIAL VALUATION

Long-term yields	
Market implied RPI inflation	3.4% p.a.
Solvency Funding Target financial assumptions	
Investment return/Discount Rate	[4.05]% p.a.
CPI price inflation*	[2.4]% p.a.
Long Term Salary increases	[3.9]% p.a.
Pension increases/indexation of CARE benefits	[2.4]% p.a.
Future service accrual financial assumptions	
Investment return/Discount Rate	[4.65]% p.a.
CPI price inflation	[2.4]% p.a.
Long Term Salary increases*	[3.9]% p.a.
Pension increases/indexation of CARE benefits	[2.4]% p.a.

*Short term salary increases may also apply

Life expectancy assumptions

The post retirement mortality tables adopted for this valuation are set out below:

Current Status	Retirement Type	Mortality Table
Pensioner	Normal Health	99% S3PMA_CMI_2018 [1.75%] 91% S3PFA_M_CMI_2018 [1.75%]
	Dependant	131% S3PMA_CMI_2018 [1.75%] 91% S3DFA_CMI_2018 [1.75%]
	Ill Health	118% S2IMA_CMI_2018 [1.75%] 130% S2IFA_CMI_2018 [1.75%]
	Future Dependant	126% S3PMA_CMI_2018 [1.75%] 108% S3DFA_CMI_2018 [1.75%]
Active	Normal Health	104% S3PMA_CMI_2018 [1.75%] 92% S3PFA_M_CMI_2018 [1.75%]
	Ill Health	120% S2IMA_CMI_2018 [1.75%] 142% S2IFA_CMI_2018 [1.75%]
Deferred	All	128% S3PMA_CMI_2018 [1.75%] 107% S3PFA_M_CMI_2018 [1.75%]
Future Dependant	Dependant	133% S3PMA_CMI_2018 [1.75%] 115% S3DFA_CMI_2018 [1.75%]

Other demographic assumptions are set out in the Actuary's formal report.

APPENDIX B

EMPLOYER DEFICIT RECOVERY PLANS

The Administering Authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period. As the assets of the Fund are less than the liabilities at the effective date, a deficit recovery plan needs to be adopted such that additional contributions are paid into the Fund to meet the shortfall.

Deficit contributions paid to the Fund by each employer will be expressed as £s amounts (with the exception of the Town and Parish Council's group where deficit contributions will be paid as a % of pensionable pay), and it is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford based on the Administering Authority's view of the employer's covenant and risk to the Fund.

Recovery periods will be set by the Fund on a consistent basis across employer categories where possible and communicated as part of the discussions with employers. This will determine the minimum contribution requirement and employers will be free to select any shorter deficit recovery period and higher contributions if they wish, including the option of prepaying the deficit contributions in one lump sum either on annual basis or a one-off payment. This will be reflected in the monetary amount requested via a reduction in overall £ deficit contributions payable.

The determination of the recovery periods is summarised in the table below:

Category	Default Deficit Recovery Period	Derivation
Fund Employers	[15] years	Determined by reducing the period from the preceding valuation by at least 3 years and to ensure deficit contributions do not reduce versus those expected from the existing recovery plan.
Open Admitted Bodies	[15] years	Determined by reducing the period from the preceding valuation by at least 3 years and to ensure deficit contributions do not reduce versus those expected from the existing recovery plan.
Closed Employers	Lower of [15] years and the future working lifetime of the membership	Determined by reducing the period from the preceding valuation by at least 3 years and to ensure deficit contributions do not reduce versus those expected from the existing recovery plan.
Employers with a limited participation in the Fund	Determined on a case by case basis	Length of expected period of participation in the Fund

In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:

- The size of the funding shortfall,
- The business plans of the employer,
- The assessment of the financial covenant of the Employer, and security of future income streams,
- Any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.

The objective is to recover any deficit over a reasonable timeframe, and this will be periodically reviewed. Subject to affordability considerations a key principle will be to maintain the deficit contributions at the expected monetary levels from the preceding valuation (allowing for any indexation in these monetary payments over the recovery period).

For any employers assessed to be in surplus, their individual contribution requirements will be adjusted to such an extent that any surplus is unwound over a [15] year period unless agreed with the Administering Authority (if surpluses are sufficiently large, contribution requirements will be set to a minimum nil total amount). The current level of contributions payable by the employer may also be phased down to the reduced level as appropriate.

OTHER FACTORS AFFECTING THE EMPLOYER DEFICIT RECOVERY PLANS

As part of the process of agreeing funding plans with individual employers, the Administering Authority will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities. All other things equal this could result in a longer recovery period being acceptable to the Administering Authority, although employers will still be expected to at least cover expected interest costs on the deficit.

It is acknowledged by the Administering Authority that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Administering Authority therefore may in some cases be willing to use its discretion to accept an evidence based affordable level of contributions for such organisations for the three years 2020/2023. Any application of this option is at the ultimate discretion of the Fund officers and Section 151 officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.

For those bodies identified as having a weaker covenant, the Administering Authority will need to balance the level of risk plus the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans. As a minimum, the annual deficit payment must meet the on-going interest costs to ensure, everything else being equal, that the deficit does not increase in monetary terms.

Notwithstanding the above, the Administering Authority, in consultation with the actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

APPENDIX C

ADMISSION AND TERMINATION POLICY

INTRODUCTION

This document details the Worcestershire Pension Fund's (WPF) policy on the methodology for assessment of ongoing contribution requirements and termination payments in the event of the cessation of an employer's participation in the Fund. This document also covers WPF's policy on admissions into the Fund and sets out the considerations for current and former admission bodies. It supplements the general policy of the Fund as set out in the Funding Strategy Statement (FSS).

- Admission bodies are required to have an "admission agreement" with the Fund. In conjunction with the Regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.

- Scheme Employers have a statutory right to participate in the LGPS and their staff therefore can become members of the LGPS at any time, although some organisations (Part 2 Scheme Employers) do need to designate eligibility for its staff.

A list of all current employing bodies participating in the WPF is kept as a live document and will be updated by the Administering Authority as bodies are admitted to, or leave the WPF.

Please see the glossary for an explanation of the terms used throughout this Appendix.

ENTRY TO THE FUND

Unless agreed otherwise by the Administering Authority, prior to admission to the Fund, an Admitted Body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the Administering Authority. If the risk assessment and/or bond amount is not to the satisfaction of the Administering Authority (as required under the LGPS Regulations) it will consider and determine whether the admission body must pre-fund for termination with contribution requirements assessed using the minimum risk methodology and assumptions.

Some aspects that the Administering Authority may consider when deciding whether to apply a minimum risk methodology are:

- Uncertainty over the security of the organisation's funding sources e.g. the body relies on voluntary or charitable sources of income or has no external funding guarantee/reserves;

- If the admitted body has an expected limited lifespan of participation in the Fund;

- The average age of employees to be admitted and whether the admission is closed to new joiners.

In order to protect other Fund employers, where it has been considered undesirable to provide a bond, a guarantee must be sought in line with the LGPS Regulations.

At the discretion of the Administering Authority, where an admission is in respect of 10 or less LGPS posts the Admitted Body will be admitted to the Fund on a 'Pass Through' basis where the Admitted Body's ongoing contribution requirements are agreed between the Letting Employer and the Admitted Body, without an individual contribution assessment being carried out.

[JOINING THE FUND VIA THE 'DEEMED EMPLOYER' ROUTE

This is an alternative route to the admitted body route for achieving pension protection. It relates to employers which have employees working for a third party but fall under the deemed employer for the purposes of the Regulations.

It will be the outsourcing Scheme Employer's choice, when initially putting the contract out to tender, whether the Admission Agreement or Deemed Employer approach will be used. The outsourcing scheme employer will be also known as the deemed employer with regard to this admitted body.

If the Deemed Employer route is chosen, the admitted body will not join the Fund and will instead be grouped/pooled with the original scheme employer. This may be used when a pass through arrangement has been agreed.

The Fund's policy will be dependent on the deemed employer's policy and approach to dealing with these outsourcings. This makes it imperative that each outsourcing scheme employer has a clear policy on the treatment of each type of admitted body. The Fund also requires an agreement (similar to the admission agreement) with the admitted body to ensure their duties are fulfilled e.g. payment of contributions.]

SECOND GENERATION OUTSOURCINGS FOR STAFF NOT EMPLOYED BY THE SCHEME EMPLOYER CONTRACTING THE SERVICES TO AN ADMITTED BODY

A 2nd generation outsourcing is one where a service is being outsourced for the second time, usually after the previous contract has come to an end. For Best Value Authorities, principally the main Councils, they are bound by The Best Value Authorities Staff Transfers (Pensions) Direction 2007 so far as 2nd generation outsourcings are concerned. In the case of most other employing bodies, they should have regard to Fair Deal Guidance issued by the Government.

It is usually the case that where services have previously been outsourced, the transferees are employees of the contractor as opposed to the original scheme employer and as such will transfer from one contractor to another without being re-employed by the original scheme employer. There are even instances where staff can be transferred from one contractor to another without ever being employed by the outsourcing scheme employer that is party to the Admission Agreement. This can occur when one employing body takes over the responsibilities of another, such as a maintained school (run by the local education authority) becoming an academy. In this instance the contracting body is termed a 'Related Employer' for the purposes of the Local Government Pension Scheme Regulations and is obliged to guarantee the pension liabilities incurred by the contractor

“Related employer” is defined as “any Scheme employer or other such contracting body which is a party to the admission agreement (other than an administering authority in its role as an administering authority)”.

LGPS REGULATIONS 2013: SCHEDULE 2 PART 3, PARA 8

Where, for any reason, it is not desirable for an admission body to enter into an indemnity or bond, the admission agreement must provide that the admission body secures a guarantee in a form satisfactory to the administering authority from—

(a) a person who funds the admission body in whole or in part;

(b) in the case of an admission body falling within the description in paragraph 1(d), the Scheme employer referred to in that paragraph;

> *(d) a body that is providing or will provide a service or assets in connection with the exercise of a function of a Scheme employer as a result of—*
>
> *(i) the transfer of the service or assets by means of a contract or other arrangement,*
>
> *(ii) a direction made under section 15 of the Local Government Act 1999 (115) (Secretary of State’s powers),*
>
> *(iii) directions made under section 497A of the Education Act 1996 (116) ;*

(c) a person who—

(i) owns, or

(ii) controls the exercise of the functions of, the admission body; or

In accordance with the above Regulations, the Fund requires a guarantee from the related employer. The related employer may seek a bond from the admitted body taking into account the risk assessment carried out by the Fund actuary.

ADMITTED BODIES PROVIDING A SERVICE

Generally Admitted Bodies providing a service (including those admitted on a Pass Through basis) will have a guarantor within the Fund that will stand behind the liabilities. Accordingly, in general, the minimum risk approach to funding and termination will not apply for these bodies.

As above, the Admitted Body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the Administering Authority. This assessment would normally be based on advice in the form of a "risk assessment report" provided by the actuary to the WPF. As the Scheme Employer is effectively the ultimate guarantor for these admissions to the WPF it must also be satisfied (along with the Administering Authority) over the level (if any) of any bond requirement. Where bond agreements are to the satisfaction of the Administering Authority, the level of the bond amount will be subject to review on a regular basis. In the case of an Admission Body admitted on a Pass Through basis, the requirement to carry out an assessment of the level of risk on premature termination of the contract may be waived at the agreement of the Administering Authority and the Letting Employer who act as guarantor to the Admission Body.

In the absence of any other specific agreement between the parties, deficit recovery periods for Admitted Bodies will be set in line with the Fund's general policy as set out in the FSS.

Any risk sharing arrangements agreed between the Scheme Employer and the Admitted Body will be documented in the commercial agreement between the two parties and not the admission agreement.

In the event of termination of the Admitted Body, any orphan liabilities in the Fund will be subsumed by the relevant Scheme Employer.

An exception to the above policy applies if the guarantor is not a participating employer within the WPF, including if the guarantor is a participating employer within another LGPS Fund. In order to protect other employers within the WPF the Administering Authority may in this case treat the admission body as pre-funding for termination, with contribution requirements assessed using the minimum risk methodology and assumptions.

PRE-FUNDING FOR TERMINATION

An employing body may choose to pre-fund for termination i.e. to amend their funding approach to a minimum risk methodology and assumptions. This will substantially reduce the risk of an uncertain and potentially large debt being due to the Fund at termination. However, it is also likely to give rise to a substantial increase in contribution requirements, when assessed on the minimum risk basis.

For any employing bodies funding on such a minimum risk strategy a notional investment strategy will be assumed as a match to the liabilities. In particular, the employing body's notional asset share of the Fund will be credited with an investment return in line with the minimum risk funding assumptions adopted rather than the notional investment return generated by the investment strategy for the employer's investment pot. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

EXITING THE FUND

TERMINATION OF AN EMPLOYER'S PARTICIPATION

Unless agreed otherwise via an employer deferred debt arrangement, an employer ceases to participate within the Fund when the last active member leaves the Fund. This includes where the employer ceases to be eligible for membership e.g. a contract with a local authority comes to an end or the employer chooses to voluntarily cease participation.

When an employing body terminates for any reason, employees may transfer to another employer, either within the Fund or elsewhere. If this is not the case the employees will retain pension rights within the Fund i.e. either deferred benefits or immediate retirement benefits.

In addition to any liabilities for current employees the Fund will also retain liability for payment of benefits to former employees, i.e. to existing deferred and pensioner members except where there is a complete transfer of responsibility to another Fund with a different Administering Authority.

The employer becomes an exiting employer under the Regulations and the Fund is then required to obtain an actuarial valuation of that employer's liabilities in respect of benefits of the exiting employer's current and former employees along with a termination contribution certificate.

When an employer exits the Fund the Regulations give power to the Fund to set a repayment plan to recover the outstanding debt over a period at its sole discretion and this will depend on the affordability of the repayments and financial strength of the exiting employer. Once this repayment plan is set the payments would not be reviewed for changes in the funding position due to market or demographic factors.

The Fund's policy for termination payment plans is as follows:

1. The default position is for exit payments and exit credits to be paid immediately in full.
2. At the discretion of the administering authority, instalment plans over a defined period will only be agreed when there are issues of affordability that risk the financial viability of the organisation and the ability of the Fund to recover the debt.
3. Any costs associated with the exit valuation will be paid by the employer by either increasing the exit payment or reducing the exit credit by the appropriate amount. In the case of an employer where the exit debt/credit is the responsibility of the original employer through a risk sharing agreement the costs will be charged directly to the employer unless the original employer directs otherwise.

In the event that unfunded liabilities arise that cannot be recovered from the exiting body, these will normally fall to be met by the Fund as a whole (i.e. all employers) unless there is a guarantor or successor body within the Fund.

With the exception of grouped employers (see below), the WPF's policy is that a termination assessment will be made based on a minimum risk funding basis, unless the employing body has a guarantor within the Fund or a successor body exists to take over the employing body's liabilities (including those for former employees).

The policy for employers who **have a guarantor** participating in the Fund:

If the employing body (including those admitted on a Pass Through basis) has a guarantor within the Fund or a successor body exists to take over the employing body's liabilities, the WPF's policy is that the valuation funding basis will be used for the termination assessment unless the guarantor informs the WPF otherwise.

The residual assets and liabilities, and hence any surplus or deficit will normally transfer back to the guarantor of the employing body within the Fund. (For Admission Bodies, this process is sometimes known as the "novation" of the admission agreement.) This may, if agreed by the successor body, constitute a complete amalgamation of assets and liabilities to the successor body. In circumstances where an exiting employer is expected to still be responsible for all or part of the termination position, an exit payment/exit credit may be payable from/to the exiting employer. This is subject to agreement from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor, in particular any 'risk-sharing' agreements that may exist. If all parties do not agree, then the surplus will be paid directly to the exiting employer (despite any other agreements that may be in place).

The policy for employers who **do not have a guarantor** participating in the Fund:

A termination assessment will be made based on a minimum risk funding basis. This is to protect the other employers in the Fund as, at termination, the employing body's liabilities will become orphan liabilities within the Fund, and there will be no recourse to it if a shortfall emerges in the future (after participation has terminated).

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process.

- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

The Administering Authority can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the actuary.

The WPF currently groups Town and Parish Councils for contribution rate setting purposes. The WPF's policy is that, on termination of participation within the group, the termination assessment will be based on a simplified share of deficit/surplus approach. This involves disaggregating the outgoing body from the group by calculating the notional deficit/surplus share as at the last actuarial valuation of the Fund, in proportion to the respective payrolls for the body and the group as a whole, and then adjusting to the date of exit. The share of deficit/surplus will be assessed based on the ongoing valuation funding basis for the group as a whole at the last actuarial valuation. The adjustment to the date of exit will normally be made in line with the funding assumptions adopted for the group as at the last actuarial valuation unless the actuary and Administering Authority consider that the circumstances warrant a different treatment, for example, to allow for actual investment returns over the period from the last actuarial valuation to exit.

In addition, for some Multi-Academy Trusts (MAT), a grouped approach has been taken with individual academies within a Trust no longer being separately identifiable on the Fund's administration system or for funding or contribution purposes. On termination of participation of one of the academies within such a MAT, the termination assessment will be based on a simplified share of deficit/surplus approach. This involves disaggregating the outgoing body from the group by calculating the notional deficit/surplus share as at the last actuarial valuation of the Fund, in proportion to the respective payrolls for the employees of the exiting academy and the MAT a whole, and then adjusting to the date of exit. The share of deficit/surplus will be assessed based on the ongoing valuation funding basis for the MAT as a whole at the last actuarial valuation. The adjustment to the date of exit will normally be made in line with the funding assumptions adopted for the MAT as at the last actuarial valuation unless the actuary and Administering Authority consider that the circumstances warrant a different treatment, for example, to allow for actual investment returns over the period from the last actuarial valuation to exit.

Unless agreed otherwise by the Administering Authority, any unfunded liability that cannot be reclaimed from the outgoing grouped body will be underwritten by the group/MAT and not all employers in the Fund. Following termination, the residual liabilities and assets in respect of that body will be subsumed by any guarantor body for the group, or in the absence of a guarantor, subsumed by the group/MAT.

It is possible under certain circumstances that an employer can apply to transfer all assets and current and former members' benefits to another LGPS Fund in England and Wales. In these cases no termination assessment is required as there will no longer be any orphan liabilities in the WPF. Therefore, a separate assessment of the assets to be transferred will be required.

FUTURE TERMINATIONS

In many cases, termination of an employer's participation is an event that can be foreseen, for example, because the organisation's operations may be planned to be discontinued and/or the admission agreement is due to cease. Under the Regulations, in the event of the Administering Authority becoming aware of such circumstances, it can amend an employer's minimum contributions such that the value of the assets of the employing body is neither materially more nor materially less than its anticipated liabilities at the date it appears to the Administering Authority that it will cease to be a participating employer. In this case, employing bodies are encouraged to open a dialogue with the Fund to commence planning for the termination as early as possible. Where termination is disclosed in advance the Fund will operate procedures to reduce the sizeable volatility risks to the debt amount in the run up to actual termination of participation. For example, on agreement with the employer, by moving the employer to a lower risk funding basis or a notional minimum risk funding basis. The Fund will modify the employing body's approach in any case, where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

[EMPLOYERS THAT JOINED VIA THE 'DEEMED EMPLOYER' ROUTE

In the event of cessation, the assets and liabilities will remain with the outsourcing scheme employer and no termination assessment or payment will be required.]

[EMPLOYERS WITH NO CONTRIBUTING MEMBERS

An employer may participate in the Fund with no contributing members and utilise the "Deferred Debt" Arrangements at the sole discretion of the Administering Authority which will be subject to a satisfactory covenant review on an ongoing basis. In this circumstance they will be treated as per any other participating employer in relation to overall funding strategy (including potentially requiring a final exit payment at some point) allowing for the covenant.]

MINIMUM RISK TERMINATION BASIS

The minimum risk financial assumptions that applied at the actuarial valuation date (31 March 2019) are set out below in relation to any liability remaining in the Fund. These will be updated on a case-by-case basis, with reference to prevailing market conditions at the relevant employing body's cessation date.

Minimum risk assumptions	31 March 2019
Discount Rate	1.5% p.a.
CPI price inflation	2.4% p.a.
Pension increases/indexation of CARE benefits	2.4% p.a.

All demographic assumptions will be the same as those adopted for the 2019 actuarial valuation, except in relation to the life expectancy assumption. Given the minimum risk financial assumptions do not protect against future adverse demographic experience a higher level of prudence will be adopted in the life expectancy assumption.

The termination basis for an outgoing employer will include an adjustment to the assumption for longevity improvements over time by increasing the rate of improvement in mortality rates to 2% p.a. from 1.75% used in the 2019 valuation for ongoing funding and contribution purposes.

APPENDIX D

COVENANT ASSESSMENT AND MONITORING POLICY

An employer's covenant (including those with no active members who are operating under a deferred debt arrangement) underpins its legal obligation and ability to meet its financial responsibilities now and in the future. The strength of covenant depends upon the robustness of the legal agreements in place and the likelihood that the employer can meet them. The covenant effectively underwrites the risks to which the Fund is exposed, including underfunding, longevity, investment and market forces.

An assessment of employer covenant focuses on determining the following:

> Type of body and its origins
> Nature and enforceability of legal agreements
> Whether there is a bond in place and the level of the bond
> Whether a more accelerated recovery plan should be enforced
> Whether there is an option to call in contingent assets
> Is there a need for monitoring of ongoing and termination funding ahead of the next actuarial valuation?

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital.

RISK CRITERIA

The assessment criteria upon which an employer should be reviewed could include:

- Nature and prospects of the employer's industry
- Employer's competitive position and relative size
- Management ability and track record
- Financial policy of the employer
- Profitability, cashflow and financial flexibility
- Employer's credit rating
- Position of the economy as a whole

Not all of the above would be applicable to assessing employer risk within the Fund; rather a proportionate approach to consideration of the above criteria would be made, with further consideration given to the following:

- The scale of obligations to the pension scheme relative to the size of the employer's operating cashflow
- The relative priority placed on the pension scheme compared to corporate finances

- An estimate of the amount which might be available to the scheme on insolvency of the employer as well as the likelihood of that eventuality.

ASSESSING EMPLOYER COVENANT

The employer covenant will be assessed objectively and its ability to meet their obligations will be viewed in the context of the Fund's exposure to risk and volatility based on publically available information and/or information provided by the employer. The monitoring of covenant strength along with the funding position (including on the termination basis) enables the Fund to anticipate and pre-empt employer funding issues and thus adopt a proactive approach. In order to objectively monitor the strength of an employer's covenant, adjacent to the risk posed to the Fund, a number of fundamental financial metrics will be reviewed to develop an overview of the employer's stability and a rating score will be applied using a Red/Amber/Green (RAG) rating structure.

In order to accurately monitor employer covenant, it will be necessary for research to be carried out into employers' backgrounds and, in addition, for those employers to be contacted to gather as much information as possible. Focus will be placed on the regular monitoring of employers with a proactive rather than reactive view to mitigating risk.

The covenant assessment will be combined with the funding position to derive an overall risk score. Action will be taken if these metrics meet certain triggers based on funding level, covenant rating and the overall risk score

FREQUENCY OF MONITORING

The funding position and contribution rate for each employer participating in the Fund will be reviewed as a matter of course with each triennial actuarial valuation. However, it is important that the relative financial strength of employers is reviewed regularly to allow for a thorough assessment of the financial metrics. The funding position will be monitored (including on the termination basis) using an online system provided to officers by the Fund Actuary.

Employers subject to a more detailed review, where a risk criterion is triggered, will be reviewed at least every six months, but more realistically with a quarterly focus.

COVENANT RISK MANAGEMENT

The focus of the Fund's risk management is the identification and treatment of the risks and it will be a continuous and evolving process which runs throughout the Fund's strategy. Mechanisms that will be explored with certain employers, as necessary, will include but are not limited to the following:

1. Parental Guarantee and/or Indemnifying Bond
2. Transfer to a more prudent actuarial basis (e.g. the termination basis)
3. Shortened recovery periods and increased cash contributions
4. Managed exit strategies
5. Contingent assets and/or other security such as escrow accounts.

APPENDIX E

GLOSSARY

Actuarial Valuation:
An investigation by an actuary into the ability of the Fund to meet its liabilities. For the LGPS the Fund Actuary will assess the funding level of each participating employer and agree contribution rates with the administering authority to fund the cost of new benefits and make good any existing deficits as set out in the separate Funding Strategy Statement. The asset value is based on market values at the valuation date.

Administering Authority:
The council with a statutory responsibility for running the Fund and that is responsible for all aspects of its management and operation.

Admission bodies:
A specific type of employer under the Local Government Pension Scheme (the "LGPS") who do not automatically qualify for participation in the Fund but are allowed to join if they satisfy the relevant criteria set out in the Regulations.

Benchmark:
A measure against which fund performance is to be judged.

Best Estimate Assumption:
An assumption where the outcome has a 50/50 chance of being achieved.

Bonds:
Loans made to an issuer (often a government or a company) which undertakes to repay the loan at an agreed later date. The term refers generically to corporate bonds or government bonds (gilts).

Career Average Revalued Earnings Scheme (CARE):
With effect from 1 April 2014, benefits accrued by members in the LGPS take the form of CARE benefits. Every year members will accrue a pension benefit equivalent to 1/49th of their pensionable pay in that year. Each annual pension accrued receives inflationary increases (in line with the annual change in the Consumer Prices Index) over the period to retirement.

CPI:
Acronym standing for "Consumer Prices Index". CPI is a measure of inflation with a basket of goods that is assessed on an annual basis. The reference goods and services differ from those of RPI. These goods are expected to provide lower, less volatile inflation increases. Pension increases in the LGPS are linked to the annual change in CPI.

Contingent Assets: assets held by employers in the Fund that can be called upon by the Fund in the event of the employer not being able to cover the debt due upon termination. The terms will be set out in a separate agreement between the Fund and employer.

Corporate Bond Employer: an employer in the Fund, under previous Fund policies, whose asset share is invested in corporate bond assets and for whom the discount rate used to assess the liabilities is determined based on the market yields of high quality corporate bond investments (usually at least AA rated) based on the appropriate duration of the liabilities being assessed. These employers will now be moved onto the lower risk funding basis.

Covenant:
The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term or affordability constraints in the short term.

Deficit:
The extent to which the value of the Fund's past service liabilities exceeds the value of the Fund's assets. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which in effect is assumed to be met by future contributions).

Deficit recovery period:
The target length of time over which the current deficit is intended to be paid off. A shorter period will give rise to a higher annual contribution, and vice versa.

Discount Rate:
The rate of interest used to convert a cash amount e.g. future benefit payments occurring in the future to a present value.

Employer's Future Service Contribution Rate:
The contribution rate payable by an employer, expressed as a % of pensionable pay, as being sufficient to meet the cost of new benefits being accrued by active members in the future. The cost will be net of employee contributions and will include an allowance for the expected level of administrative expenses.

Employing bodies:
Any organisation that participates in the LGPS, including admission bodies and Fund employers.

Equities:
Shares in a company which are bought and sold on a stock exchange.

Equity Protection:
An insurance contract which provides protection against falls in equity markets. Depending on the pricing structure, this may be financed by giving up some of the upside potential in equity market gains.

Exit Credit:
The amount payable from the Fund to an exiting employer in the case where the exiting employer is determined to be in surplus at the point of cessation based on a termination assessment by the Fund Actuary.

Fund / Scheme Employers:
Employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the Part 2 Fund Employers.

Funding or solvency Level:
The ratio of the value of the Fund's assets and the value of the Fund's liabilities expressed as a percentage.

Funding Strategy Statement:
This is a key governance document that outlines how the administering authority will manage employer's contributions and risks to the Fund.

Government Actuary's Department (GAD):
The GAD is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.

Guarantee / guarantor:
A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's covenant to be as strong as its guarantor's.

Investment Pot:
this describes a bespoke notional investment strategy which applies to one or more employers and is dependent on the liability and risk profile. Dictates the financial assumptions used to determine the employer's contribution requirements. The relevant discount rate used for valuing the present value of liabilities is determined based on the notional investment strategy for the relevant investment pot's investment strategy. This is expressed as an expected return over CPI.

Investment Strategy:
The long-term distribution of assets among various asset classes that takes into account the Funds objectives and attitude to risk.

Letting Employer:
An employer that outsources part of its services/workforce to another employer, usually a contractor. The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer.

Liabilities:
The actuarially calculated present value of all benefit entitlements i.e. Fund cashflows of all members of the Fund, built up to date or in the future. The liabilities in relation to the benefit entitlements earned up to the valuation date are compared with the present market value of Fund assets to derive the deficit and funding/solvency level. Liabilities can be assessed on different set of actuarial assumptions depending on the purpose of the valuation.

LGPS:
The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements.

Lower risk funding basis:
An approach where the discount rate used to assess the liabilities is determined based on the expected long term return achieved on the Fund's lower risk investment strategy. This is usually adopted for employers who are deemed to have a weaker covenant than others in the Fund, are planning to exit the Fund or would like to target a lower risk strategy. This basis is adopted for ongoing contribution rate purposes as the employers' asset share is invested in the lower risk investment strategy.

Lower risk investment strategy:
An investment strategy linked to income generating assets which target a minimum yield above CPI inflation allowing for default, reinvestment risk and any other reasonable margins of prudence deemed appropriate.

Mandatory scheme employers:
Employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the Part 2 Scheme Employers. For example, these include councils, colleges, universities and academies.

Maturity:
A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.

Members:
The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).

Minimum risk basis:
An approach where the discount rate used to assess the liabilities is determined based on the market yields of Government bond investments based on the appropriate duration of the liabilities being assessed. This is usually adopted when an employer is exiting the Fund.

Orphan liabilities:
Liabilities in the Fund for which there is no sponsoring employer within the Fund. Ultimately orphan liabilities must be underwritten by all other employers in the Fund.

Pass Through:
Arrangement whereby the risks of participating in the LGPS are retained by the Letting Employer with the Admission Body's contributions being a reflection of the rate of the Letting Employer (subject to any specific adjustment required under the separate contractual arrangement).

Percentiles:
Relative ranking (in hundredths) of a particular range. For example, in terms of expected returns a percentile ranking of 75 indicates that in 25% of cases, the return achieved would be greater than the figure, and in 75% cases the return would be lower.

Phasing/stepping of contributions:
When there is an increase/decrease in an employer's long term contribution requirements, the increase in contributions can be gradually stepped or phased in over an agreed period. The phasing/stepping can be in equal steps or on a bespoke basis for each employer.

Pooling:
Employers may be grouped together for the purpose of calculating contribution rates, (i.e. a single contribution rate applicable to all employers in the pool). A pool may still require each individual employer to ultimately pay for its own share of deficit, or (if formally agreed) it may allow deficits to be passed from one employer to another.

Prepayment:
The payment by employers of contributions to the Fund earlier than that certified by the Actuary. The amount paid will be reduced in monetary terms compared to the certified amount to reflect the early payment.

Present Value:
The value of projected benefit payments, discounted back to the valuation date.

Primary rate:
The contribution rate required to meet the cost of future accrual of benefits, ignoring any past service surplus or deficit but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer's covenant.

Profile:
The profile of an employer's membership or liability reflects various measurements of that employer's members, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc.

Prudent Assumption:
An assumption where the outcome has a greater than 50/50 chance of being achieved i.e. the outcome is more likely to be overstated than understated. Legislation and Guidance requires the assumptions adopted for an actuarial valuation to be prudent.

Rates and Adjustments Certificate:
A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal valuation. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.

Real Return or Real Discount Rate:
A rate of return or discount rate net of (CPI) inflation.

Recovery Plan:
A strategy by which an employer will make up a funding deficit over a specified period of time ("the recovery period"), as set out in the Funding Strategy Statement.

Scheduled bodies:
Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).

Secondary rate:
The adjustment to the Primary rate to arrive at the total contribution each employer is required to pay. It is essentially the additional contribution (or reduction in contributions) resulting from any deficit (or surplus) attributable to the employer within the Fund.

Section 13 Valuation:
In accordance with Section 13 of the Public Service Pensions Act 2014, the Government Actuary's Department (GAD) have been commissioned to advise the Department for Communities and Local Government (DCLG) in connection with reviewing the 2016 LGPS actuarial valuations. All LGPS Funds therefore will be assessed on a standardised set of assumptions as part of this process.

Solvency Funding Target:
An assessment of the present value of benefits to be paid in the future. The desired funding target is to achieve a solvency level of a 100% i.e. assets equal to the accrued liabilities at the valuation date assessed on the ongoing concern basis.

Valuation funding basis:
The financial and demographic assumptions used to determine the employer's contribution requirements. The relevant discount rate used for valuing the present value of liabilities is consistent with an expected rate of return of the Fund's investments. This includes an expected out-performance over gilts in the long-term from other asset classes, held by the Fund.

50/50 Scheme:
In the LGPS, active members are given the option of accruing a lower personal benefit in the 50/50 Scheme, in return for paying a lower level of contribution.

Worcestershire Pension Fund 2019 Funding Strategy Statement Consultation Response

Employer	2019 Funding Strategy Statement Consultation Response
Q1: What prepayment options should be available e.g. 100% (deficit repayment) / 90% (future service contributions) annually in advance; all 3 years 100% / 90% in advance; first two years 100% / 90% in advance; etc?	
Employer A	We would like to see the following options: • Annual in advance * • 2 years in advance * • An option to pay the 3rd year at the start of the second year • 3 years in advance *with an option to consider this in each of the years rather than only at the outset
Employer B	Considering the on-going uncertainty over Government policy on student tuition fees the University does not currently envisage having sufficient excess cashflow to consider the prepayment option. Consequently, it is irrelevant what options are made available
Employer C	We think it is a good idea to offer alternatives as in previous years e.g. monthly, prepaid annually, all 3 yrs. prepaid. We have in the past paid annually in advance but unfortunately with budgets the way they are currently and with uncertainty over funding and future costs we cannot afford to prepay now. I don't know how easy it would be to add in a last 2 yrs. in advance option in case our situation improves? Or in this case would we still have the possibility of paying yrs. 2 and/or 3 in advance or do we have to decide in advance what path we are taking?
Employer D	Affordability issues means prepayments are not currently an option for our Trust
Employer E	100% annually in advance
Employer F	100% Deficit repayment
Employer G	As the school would like to know more about extending the deficit recovery period (question 3), it is unlikely that additional payments/ prepayments will be considered in addition to annual deficit recovery amount(s) and future service % contributions. However, having the option to make prepayments, i.e. at year end, would be useful to know more about. This amount, if linked to end of year, would fluctuate on an annual basis
Employer H	100% deficit repayment
Employer I	Our preference is to pay for all 3 years in advance as previously.

Employer	2019 Funding Strategy Statement Consultation Response
Employer J	We do not expect that we will use any prepayment options, so we have no preference on the options that should be available
Employer K	Our preference is to continue as we do now, pay the Future Service Amount monthly and 100% of the annual Deficit Recovery Amount each year, with the discount applied to this annual payment.
Employer L	All options should be available, but the clear preference would be all 3 years 90% in advance.
Q2: When you think the investment pots should be made available; which investment pot you think might be appropriate for you; whether we should introduce other investment pots and what any other pots should look like? (Even if you do not believe this flexibility will be appropriate for you at the 2019 valuation, we would appreciate your comments in relation to this framework being available for use at a future valuation)	
Employer A	There should be an option to invest funds across pot with different risk ratings. As an academy we are most likely to choose the high-risk investment pots.
Employer B	No view on the timing of when different investment pots become available. Currently the University regards itself as having a strong covenant position so is prepared to accept the current 'higher risk pot'. However, if Government policy regarding the funding of the Higher Education Sector continues to reduce the ability of the University to grow and generate cash then the covenant position might alter, and a reduced level risk pot would become more appropriate.
Employer C	I think having different investment pots is worth exploring but now our budgets are more driven by the need to reduce costs rather than manage risks.
Employer D	As an Academy Trust we would consider a riskier longer-term investment pot which would generate more opportunity for return for us and similar schemes where funding levels of significantly below the scheme average.
Employer E	High, medium and low risk with ability to switch on an annual basis
Employer F	Higher risk pot as at present
Employer G	If other investment posts should be made available, the Governing Body of the school would need sufficient information and guidance to understand the risks associated. If other investment pots provide the opportunity to reduce the level of funding associated with the deficit recovery period, they should be made available for discussion.
Employer H	Happy with existing approach/medium risk, we don't envisage exiting the scheme soon
Employer I	The investment pots should be made available from the earliest opportunity i.e. 2020/21 year. The Higher Risk pot appears to be the most appropriate, given our financial position. The choice of 4 pots seems about right.
Employer M	We had a meeting yesterday within our trust, and we would like our contributions over the next three years to be at the lower risk and include the 0.5% for the McCloud case

Employer	2019 Funding Strategy Statement Consultation Response
Employer J	We do not expect that we will make use of this flexibility soon. We welcome the introduction of alternative investment options for participating employers but do not have any strong views on what options should be offered.
Employer K	Given the increased costs to academies and our current funding issues, are there alternative “pots” that would potentially reduce our expenditure?
Employer L	It would be beneficial for the investment pots to come onstream over the course of the next financial year. The County Council would consider the existing higher risk investment strategy pot considering our view of covenant strength. Looking forward, the option to consider new investment pot, with perhaps a greater appetite for risk / return could be considered
Q3: Whether we should offer employers with proven short term LGPS affordability problems the option to phase in the increases to their future service % contributions or a longer deficit recovery period? NB if an employer goes bust, other employers must pick up the bill for making good on that employer’s pension promises	
Employer A	Future service contributions should be set at the rate determined by the triennial valuation, not doing this could expose employers to risks they are not fully aware of because most employers take account of current pension costs when they decide staff pay but do not consider future increases. We support extending the deficit recovery period for employers who are unable to afford the back-funding payments however approval should not be automatic and must be subject to a review.
Employer B	The affordability of the whole scheme, given ever-increasing demands to increase cash payments is a major concern to the University. High level internal discussions have taken place about the viability of the University continuing to offer such a costly pension scheme. Whilst currently no specific actions have been taken this is kept under constant review, especially if there are increased demands on cashflow relating to deficit recovery. Accordingly, the University does <u>not</u> support any suggestion to reduce the deficit recovery period to 15 years, as per the draft document. Instead the University would want to stick with the current 18-year time period, or indeed extend this to 20 years. Similarly, there is absolutely no expectation that the University, with its own current LGPS deficit position to fund, would be able to fund anyone else’s pension scheme deficit or shortfall.
Employer C	I think that offering the employers those options would be a good idea, provided the problems are just short term and they were able to then fund future contributions going forward. I believe this has been offered in the past

Employer	2019 Funding Strategy Statement Consultation Response
	especially when academies first converted but I don't know what the uptake was and whether this was a good solution for those employers or for the scheme as a whole As an academy I was told that the DfE would pick up the bill if the academy failed – that's what Mercers told me at the meeting. Is that not the case? Or is it just then passed back to all the other employers?
Employer D	Longer deficit period and for our Trust to be at the average recovery period of 15 years or 18 years if considering affordability
Employer E	Longer deficit recovery period only
Employer F	Slightly longer deficit recovery period
Employer G	The Governing Body would like to know whether we have the option to increase the deficit recovery period, thus reducing the annual deficit recovery amount(s) and phase in the increase to future service % contributions. The school is looking at all avenues to improve the overall (short and long term) budget position. The Governing Body would like to know, if one of these options was possible, what risks, in any, would need to be considered.
Employer H	No, I don't see why we should be on the hook for additional contributions and, if a company has a problem, allowing them to have a longer recovery period is likely to increase the burden on the rest of us
Employer I	Agree that such employers should be offered this option providing we are satisfied about their longer-term covenant strength and / or there is a guarantor in place
Employer J	We welcome the ability for employers with short term affordability problems to be given options to phase in increases or pay off their deficits over longer periods. We believe that recovery periods should be such that they are affordable but do not place undue financial pressures on employers. For HMFA, the reduction in the deficit recovery period from 9 years to 6 years has resulted in a significant increase in our projected contributions despite our deficit reducing since 2016 and we would be interested in understanding whether any alternative recovery periods could be considered. We would also like to understand the process for determining the deficit recovery periods for HMFA and other academies as it is not obvious from the draft FSS why a 9-year recovery period was chosen in 2016 and why this needs to reduce to 6 years for the 2019 valuation. We are also keen to understand the approach that will be taken for the next valuation in 2022 and subsequent valuations. If the deficit recovery period is reduced further from 6 years to 3 years at the next valuation, this would be likely to result in a completely unaffordable level of contributions for us. We do not therefore believe that reducing the period by 3 years at each valuation is a realistic approach.

Employer	2019 Funding Strategy Statement Consultation Response
	We would expect sufficient due diligence to be undertaken by the Fund to ensure that any employers paying lower contributions now will be able to meet their commitments at a future date, to avoid the risk that remaining employers are not put at risk of increased contributions because of them failing to make the contributions due.
Employer K	As per comment 2, affordability is a current problem area for academies, there should be an option to change the average recovery period back to 18 years or at least phase it in slowly. There should be an option to phase in the increase to future service % contributions. We should only be responsible for our own pot.
Employer L	There should always be scope for the fund to consider this, subject to matters arising, impact on covenant strength and future consideration for the relevant sector
Q4: Whether you plan to make a provision in your contributions for the potential impact of McCloud to give yourself budgeting certainty for the next 3 years? NB the current remedy for the McCloud judgment and the timing of this remedy is unknown. However, employers making a provision at the 2019 valuation by paying the higher suggested McCloud contributions will not have their contributions adjusted before 2023 / 2024, but those choosing to wait for the McCloud remedy to be identified exactly will be asked to pay whatever that turns out to be going forward and to make good on that on a 'backdated to 1 April 2020' basis	
Employer A	We intend to include provision for McCloud in our contributions. There should be recognition of early payment for employers who have chosen this, if there is none we may well opt to place these funds on long-term deposit rather than pay early.
Employer B	As already stated, given the uncertainty of Government policy coupled with the demographic downturn in 18-year olds, the University will experience tight cashflows for the next few years. Consequently, there is no intention to accelerate any payments relating to McCloud, or any other such legal cases. If in the future this crystallises and there is an attempt at backdating a large sum of money, then that will be evaluated then
Employer C	We are not planning to make a provision for the potential impact of McCloud at this stage, partly because of the uncertainty of the outcome and partly because we cannot afford another £20,000 contribution on top of the additional £35,000 which we will have to pay next year compared to this. We are hoping that changes to funding proposed by the government will make a significant difference to us and mean we will be able to cover any additional amounts that may arise because of the McCloud judgment in future
Employer D	No – affordability would not allow us to pay higher rates.
Employer E	Yes, plan to make provision within the contribution
Employer F	We will take advice from our external Auditors

Employer	2019 Funding Strategy Statement Consultation Response
Employer G	The Governing Body have decided to wait for the McCloud remedy to be identified. As the school would like to know more about extending the deficit recovery period, it would not make sense to commit to this for the time being. The Governing Body have agreed to include the potential figures within the school budget, to be aware of the potential impact. However, as above, the school is choosing to wait for the McCloud remedy to be identified before committing to fund the provision
Employer H	Don't mind, we will pay the contributions that the actuary suggests
Employer I	We would prefer to make provision in our contributions for the potential impact of McCloud, to give certainty for the next 3 years.
Employer M	We had a meeting yesterday within our trust, and we would like our contributions over the next three years to be at the lower risk and include the 0.5% for the McCloud case
Employer J	We would prefer budget certainty over a significant increase in contributions after three years, and therefore plan to make additional provision in our contributions arising from the 2019 valuation rather than waiting for 2023/24.
Employer K	We have planned to make provision for McCloud to ensure we have budget certainty.
Employer L	Yes we would like to do make this provision to get greater certainty of cost impact and reduce the risk of external audit challenge to accounting for likely impact.
Q5: Whether you feel the real pay assumption of CPI + 1.5% p.a. is appropriate? NB this assumption is an average long-term assumption over the total future working lifetime of the active membership of the Fund and should not be considered against any short term budgeted pay restraint.	
Employer A	No Comment
Employer B	The actuaries should be best placed to answer this question but from a University perspective a more realistic assumption would be a flat +2% (i.e. not linked to CPI but reflecting future budget assumptions).
Employer C	As far as anyone can tell in the current climate! The biggest impact in recent years has been the increases arising because of increasing the living wage and the knock-on effect on other pay scales as a result.
Employer D	Our budgets are currently based on no more than 2% pay increase for local government pay scale increases for the next 5 years. Budget pressures mean that this will require savings to be made in other areas to maintain education standards. We would require a short term pay restraint to be factored in to contribution calculations.
Employer E	Probably too high an estimate, CPI + 1% would be more realistic

Employer	2019 Funding Strategy Statement Consultation Response
Employer F	Yes, realistic
Employer G	Unable to comment.
Employer H	Long term possibly, will all depend on the longer-term direction of travel on NLW as most of our members are impacted by that and in the short term that will continue to run at 4-5%
Employer I	This seems appropriate.
Employer J	Our pay increases are not determined by us and therefore we cannot comment on whether this assumption is appropriate
Employer K	The pay assumption made by LGPS assumes we will be offering the nationally agreed local government pay awards. Historically we do not. According to our budgeted figures for 20/21, our payroll assumption is £76k less than the 2019 valuation estimate. Could this be looked at as it is significantly different to the actuarial figures and could potentially change the current Future Service Rate % which we have been given?
Employer L	From a finance perspective this is reasonable but there is risk not least with whomever is in government post the general election.
Q6: Whether you might be interested in ill health liability insurance: under this (the exact terms would be provided once an analysis of our members has been completed by the insurer) you would pay lower % future service contributions to the pension fund but also pay an additional say 3% contributions which would not be invested in the Fund, but be used to pay the insurance premium. In return for which a contribution would be paid by the insurance company to the pension fund on the occurrence of an ill health retirement. NB For smaller employers, the cost of a single ill-health could have a large impact on your funding position, as an employee aged 30 earning £49,000 who retires on tier 1 ill health is being 'promised' an immediate extra annual pension paid for the rest of their life of (49,000 ÷ 49 * (years between State Pension age of 68 less 30)) = £38,000 p.a. that could be expected to be paid for 50 years (until the employee dies at 80) making a total extra pension paid out of £1,900,000	
Employer A	We are interested in receiving a cost comparison for this
Employer B	Whilst this would no doubt be a 'nice-to-have' the affordability issue would mean that the University would not be interested in this option.
Employer C	We have only had one ill health retirement in the last 16 years since I have been here and that was this year and so I am not sure it has been considered in our figures. Therefore, I am not sure we would be interested based on our own experience to date. However, I can see the benefit if employers had experienced a large volume of ill-health retirements historically.

Employer	2019 Funding Strategy Statement Consultation Response
Employer D	Likely to be unaffordable considering the educational funding environment and pressures we are under from all aspects
Employer E	Not particularly interested, its complicated enough as it is!
Employer F	Yes
Employer G	Yes. The school would be interested to know more about ill health liability insurance. We would also like to know whether insurance can part fund i.e. 90% of a single ill health claim and how this would impact on contributions.
Employer H	No thank you
Employer I	No, we would prefer to self-insure for this
Employer J	We would be interested in finding out more information, so we can make an informed decision as to whether this might be something we would want to consider.
Employer K	We have no available budget for such provision.
Employer L	Not sure would need to see further modelling to consider the benefits – the council is large employer and the absence of such an arrangement (as is currently the case) may not be material for large employer.

worcestershire countycouncil

AGENDA ITEM 7

PENSIONS COMMITTEE
13 DECEMBER 2019

STRATEGIC ASSET ALLOCATION REVIEW DECEMBER 2019

Recommendation

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

   a) **The Strategic Asset Allocation recommendations set out in paragraph 5 of the report be approved: and**

   b) **The Strategic Asset Allocation actions set out in paragraph 7 of the report be included in the Forward Plan of the Committee and the Pension Investment Sub-Committee.**

Purpose of Report (Section 1)

2. The Worcestershire Pension Fund (the Fund) is valued at £2.9 billion as at the end of October 2019. The Fund's value has risen by £0.9 billion since the last triennial valuation in 2016 when it was valued at £2.0 billion.

3. The purpose of this Strategic Asset Allocation Report is two-fold:

   a) to set the scene and take stock on the performance and composition of the Fund's Strategic Asset Allocation as endorsed by the Pensions Committee in 2016 (See Sections 4 and 5 of this report);

   b) to recommend for approval any changes required to the Fund's Strategic Asset Allocation with the aims of:

      i. meeting the requirements of the Fund's draft 2019 Funding Strategy Statement;

      ii. maintaining targeted returns,

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

      iv. Ensure that sufficient resources are available to meet all liabilities as they fall due

4. The report also provides a:

   a) Summary of Recommendations (Section 2)

   b) Executive Summary (Section 3)

   c) Review of the Funds (including conclusions)

      a. Strategic Asset Allocation including Risk (Section 6)

      b. Equities (Section 7),

c. Equity Protection Strategy (Section 8)

d. Fixed Income (Section 9)

e. Exposure to Currency and inflation (Section 10)

f. Property and Infrastructure (Section 11)

g. Net Cashflow Requirements (Section 12)

h. Responsible Investment, Climate change and Impact Investing (Section 13)

Summary of Recommendations (Section 2)

5. Set out below is a summary of the recommendations contained in this report for approval at the Pensions Committee. The recommendations are to enable the Fund to continue to meet the assumptions contained within the Fund's Funding Strategy Statement with regards to ongoing expected returns more than CPI inflation and consider Central Government's asset pooling agenda that established the LGPS Central pool from the 1 April 2018:

Recommendation 1 (paragraph 176).

a) Increase the allocation to Infrastructure or a mix of Infrastructure and Real Estate by 5% from the current strategic allocation of up to 15% of the Fund to 20%.

b) Delegation is sought for the Chief Financial Officer in consultation with the Chair of the Pensions Committee and the Chair of the Pensions Investment Sub Committee to procure appropriate investment managers to secure increases to existing investments or enter new investments.

Recommendation 2 (paragraph 177).

c) The Fund's existing investment into both Property and Infrastructure result in Capital distributions in between Strategic Asset Allocation reviews as the capital element of those investments is depreciated.

d) Therefore, a "rolling" investment programme either from follow on funds from existing fund managers or suitable alternative fund managers is proposed to continue for Property and Infrastructure investments to reinvest distributions that are received in that way in order that actual investment in this asset class is maintained at the levels up to those indicated in this Strategic Asset Allocation.

Recommendation 3 (paragraph 142).

e) Maintain the Fund's allocation to Passive Equity Alternative Indices at 15% within the strategic equities allocation currently at this stage.

f) Approval is sought for Fund officers with the support of the Fund's current alternative indices investment Manager, Legal and General Asset Management, to also consider the appropriate balance of alternative indices to support the Fund's investment objectives.

Recommendation 4 (paragraph 121 and 123)

g) To fund the above structural asset allocation changes, it is recommended that the asset allocation structural changes be implemented through an overall 5% reduction to each regional market capitalisation indices passive equity allocation pro-rated equally based on the previous target allocation

h) Approval is sought for Fund officers with the support of the Fund's current alternative indices investment Manager, Legal and General Asset Management, to also consider the appropriate optimal reduction / mix in regional market capitalisation indices passive equity allocation to support the Fund's investment objectives and that

i) A review of regional equity weightings be carried out in particular the allocation to UK and US equities. A regular review of regional equity weightings is recommended to form part of a more dynamic approach to asset allocation undertaken by the Pension Investment Sub Committee

Recommendation 5 (paragraph 159).

j) Maintain the Fund's current Target Fixed Income allocation at 10% and consider increasing the actual allocation to the full target allocation.

Recommendation 6 (paragraph 26).

k) Tolerance ranges as set out below are implemented and maintained to allow the required portfolio flexibility.

Table 1: Summary Changes to the Strategic Asset Allocation

By Review Year	2016		2019	
Asset Type by %	**Allocation**	**Tolerance**	**Allocation**	**Tolerance**
Equities	75	70 - 85	70	65 - 75
Fixed Income	10	5 – 15	10	5 - 15
Infrastructure and Property	15	5 – 15	20	15 - 25

Recommendation 7 (paragraph 35).

l) To agree to the principle that the Fund operates three distinct investment strategies or ‘pots’, being **Higher, Medium and Low** and that detail of how this will be implemented and managed be bought to the March Pensions Committee for approval.

Recommendation 8 (paragraph 145d).

m) Agree to use the Equity Protection strategy as a tool to manage and mitigate the risk of having still a relative high equity exposure but review regularly and update at Pensions Investment Sub Committee.

n) Agree trigger points were discussions should take place to discuss if any action such as restructuring or even exiting the Equity Protection strategy and

o) Agree that Fund officers with the support of the Fund's current Investment Advisor closely monitor the existing strategy and bring back more detailed information on how the strategy has performed at least on a quarterly basis to Pensions Investment Sub Committee

Recommendation 9 (paragraph 187).

p) Note the suggestion of a high-level liquidity waterfall for accessing cash and that this be discussed further at the next Pensions Investment Sub Committee

Recommendation 10 (paragraphs198 to 200).

q) Review further how Responsible Investment is integrated into the Strategic Asset Allocation and update the Investment Strategy Statement for the March Pensions Committee.

6. Going forward we will bring recommendations as to the appointment of appropriate Investment Managers as these will naturally fall to the continued plan of reviews.

7. The following actions are recommended in accordance with the other responsibilities of the Pensions Committee and Pensions Investment Sub Committee to be included in the Forward Plan of the Pensions Committee and Pensions Investment Sub Committee.

Recommendation 11 (paragraph 171).

a) To plan in at least annually intervals the Fund's exposure to currency and inflation risks given the global nature of the Fund's investments as well as the bias towards Equities

Recommendation 12

b) To review the Asset Allocation Strategy quarterly and have an annual formal review / stock take

Recommendation 13 (paragraph 41)

c) To map existing and future allocation requirements across to LGPS Central and implement a consistent framework to help review options and ensure good engagement with the pool.

Recommendation 14 (paragraph 131)

d) To review the Far East Developed mandate exploring several options suggested in paragraph 7.32

Recommendation 15 (paragraphs 112 and 113)

e) To review the appropriateness of ‘active versus passive’ as part of traditional index passive mandates. i.e. UK, US and Europe

Executive summary (Section 3)

8. This report sets out the analysis and conclusions of the review of Worcestershire Pension Fund Strategic Asset Allocation. It covers a range of investment issues pertinent to the Fund. The key findings from the review are detailed below.

9. The fund has a much-improved funding position in 2019 than 2016 being 91% funded. However, it still has a deficit and the objective of the Fund should be to maintain returns that the Fund is currently delivering within a structure that achieves reduced volatility and improved diversification

10. However as detailed in paragraph 37 below, translating the Fund's investment and funding objectives into a single suitable investment strategy is challenging. The key objectives often conflict. For example, minimising the long-term cost of the scheme is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down frequently in fairly large moves), which conflicts with the objective to have stable contribution rates.

11. Additionally, the number of employers in the Fund has increased in recent years meaning that there are groups of employers with different underlying characteristics and with different long-term funding objectives.

12. In order that the Fund delivers on its key objectives; ensuring that each employer takes the appropriate level of investment risk, giving each the best opportunity possible to achieve its long-term funding objective whilst increasing certainly of cost, the Fund is looking to operate three distinct investment strategies or 'pots', being Higher, Medium and Low.

13. The risk versus return of the current proposed strategy highlighted in Hymans report and in Figure 12 of this report in paragraph 172 showed the continuing risk mitigation of the Equity Protection Strategy and the impact of increasing the Fund's allocation to Property and Infrastructure or a combination of each. This is expected to maintain expected return, reduce risk / volatility, add diversification and continue to offer some inflation hedge to the overall portfolio.

14. The aim of investment risk management should be to minimise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the whole Fund portfolio. This is achieved by asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) to an acceptable level.

15. After a long period in which equity investors have seen excellent returns on their portfolios, some caution should now be considered prudent as we appear to be entering a period of uncertain global growth. It is within this more uncertain environment that active developed market managers can more readily outperform passive benchmarks, as investors become more focused on individual company prospects

16. There is no clear case to move from regional allocation of equities to global currently. Global exposure is also gained through the Fund's passive alternative indices allocation, so in reality the Fund employs a mixed approach to equities asset allocation.

17. From the peer group evidence provided the Fund doesn't currently contract best in class active equity managers but neither do we have the lowest performing. The Emerging Markets mandate has now transitioned to LGPS Central, with Corporate Bonds due to follow shortly. We will be monitoring the performance of their appointed managers closely. This just leaves our Developed Asian Markets outstanding and a review of the options that will be considered are detailed in paragraph 131.

18. The passive alternative indices have added additional returns and reduced volatility compared to market capitalisation indices.

19. The Equity Protection strategy should only be used as a tool to manage and mitigate the risk of having still a relative high equity exposure but review regularly and update at Investment Sub Committee

20. Both Bfinance and more recently Hymans believe private debt can provide strong growth within the Fixed Income Portfolio, but with reduced market-to-market volatility, more transparency and prefer the visibility of return through contractual income offered by private debt opportunities.

21. There is little evidence that currency hedging adds to returns over time. The Fund is aware that investing in overseas equities introduces an element of currency risk, but given the level of diversification within the Fund, the Fund is comfortable taking this risk in general but may act to mitigate potentially significant risks as and when they are identified.

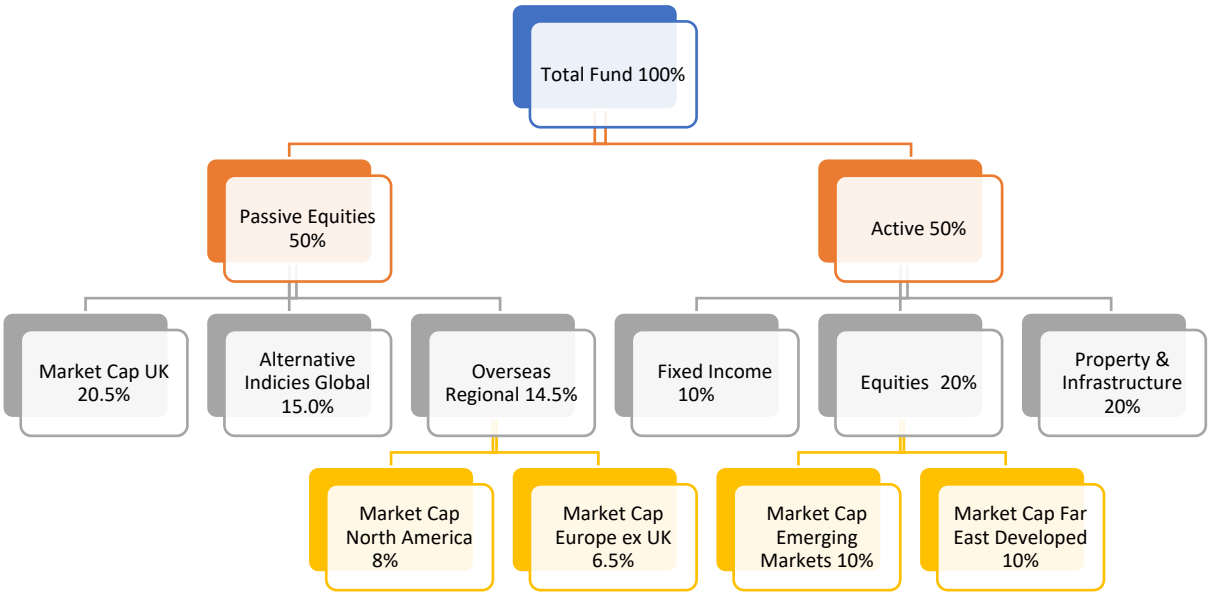
22. The Fund is currently marginally cashflow negative in the current year due to several main employers within the pension fund prepaying their 3-year contributions in April 2017. This, together with the likelihood that employers will seek to reduce or extend deficit repayments at the 2019 valuation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

23. The list of reasons to invest responsibly is growing. Building a better society and protecting the planet by funding companies that treat employees with respect, conserve water and reduce climate- damaging carbon emissions is a motivation for many. The Fund needs to refresh its Investment Strategy Statement to take on board the increasing aspects of Responsible Investment (RI), climate change and Impact Investment. However, from an asset allocation perspective, it would be preferable to think about impact and RI strategies within well-established asset classes rather than as a standalone bucket. The fund should also consider the Sustainable investment products in paragraph 194 of this report being developed by LGPS Central and West Midlands Pension Fund to assess whether these are suitable investments within the Funds evolving strategic asset allocation framework.

24. This will be an evolving strategy and the overall conclusion and proposal as shown in Figure 1 below is to increase the allocation to Infrastructure or a mix of Infrastructure and Real Estate by 5% from the current strategic allocation of up to 15% of the Fund to 20% and reduce the overall Equity strategic allocation exposure (proposal to reduce Market Cap indices element) by 5% (from 75% to 70%), with Fixed income remaining at 10%. This will help reduce portfolio risk and reduce portfolio concentration to large cap companies and therefore increase diversification across the number and size of companies in which the portfolio invests.

25. The new proposed structure is designed to maintain current long term expected returns whilst reducing asset volatility and downside risk and thus reducing the volatility of the Fund during periods of economic crisis. The 5% increased allocation to Infrastructure and Property from Equities is designed to maintain expected returns, reduce volatility and increase the level of inflation hedge within the portfolio.

Figure 1 Proposed structure change



26. The proposed tolerance ranges as set out in Table 2 below are implemented and maintained to allow the required portfolio flexibility.

Table 2 tolerance ranges

Asset Type	Core Asset Allocation	Range %
Equities	70%	65 - 75
Fixed Income	10%	5 – 15
Infrastructure and Property	20%	15 – 25

Section 4: Setting the Scene for the Strategic Asset Allocation Review

27. This section sets out the emerging findings of the Triennial Actuarial valuation, summarises progress being made with Central Government's Local Government Pension Scheme (LGPS) reforms including the implementation of LGPS Central, the key findings of the initial investment strategy review undertaken by Hymans Robertson LLP in February 2019 and reported to Committee in March 2019 and an update on the Equity Protection.

Section 4: Setting the Scene: Initial Strategic Asset Allocation Review conducted by Hymans Robertson LLP in February 2019

28. 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. This was conducted by Hymans

Robertson and the key findings of the report which were reported to Pension Committee in March 2019 together where these are covered in the report are detailed in Appendix 1.

Section 4: Setting the Scene: Triennial Actuarial Valuation

29. The Fund is nearing conclusion on its discussions with the Actuary, Mercer, on the triennial valuation. A full report will be presented to the Pension Committee at its meeting on 13th December 2019. In summary, the likely outcome will be:

a) Recognition of excess returns above Actuarial estimates made as part of the 2016 triennial actuarial valuation which will result in a decrease in the deficit;

b) An increase in the Future rate due to a more prudent actuary outlook on the Fund's liabilities. The valuation of the real return over CPI inflation for determining the past service liabilities is 1.65% (2.15% in 2016) per annum and for determining the future service ("Primary") contribution rates is 2.25% (2.75% in 2016) per annum. CPI inflation has been assumed at 2.4% on average over the review period making the total discount rate / investment return target of 4.65%

c) An increase in the funding level from 75% to 91.3% with a similar funding strategy required.

d) Providing employers, a choice on the 'McCloud' implications to include these estimated costs over 2020/23 as part of their certified contributions or to make allowance within their budgets and potentially make backdated contributions if the remedy is known before the next valuation

30. This means that there is not a need to fundamentally alter the Fund's Funding Strategy Statement in any significant way and therefore the aims of its investment strategy remain intact.

31. The Actuary has reflected on the Fund's ability to manage any future risk around inflationary pressures and volatility of returns and asset valuations due to the Fund's bias towards Equity as an asset class

32. Whilst this bias is a conscious one that members of the Pensions Committee will be familiar with, it should also be recognised that the strategic allocation to this asset class has reduced from 90% in the 2010 Strategic Asset Allocation to 80% in the 2013 Strategic Asset Allocation and reduced to 75% in the 2016 Strategic Asset Allocation. This reduction has been matched by implementing an Equity Protection Strategy against its passive equity portfolio and an increase in Property and Infrastructure as an asset class. The nature of which have moved inherent protections against future inflationary pressures and historically have been less volatile in terms of valuation than Equities.

Investment Strategies / 'Pots' and the Funds objectives

33. Translating the Fund's investment and funding objectives into a single suitable investment strategy is challenging. The key objectives often conflict. For example, minimising the long-term cost of the scheme is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down frequently in large moves), which conflicts with the objective to have stable contribution rates.

34. Additionally, the number of employers in the Fund has increased in recent years meaning that there are groups of employers with different underlying characteristics and with different long-term funding objectives.

35. In order that the Fund delivers on its key objectives; ensuring that each employer takes the appropriate level of investment risk, giving each the best opportunity possible to achieve its long-term funding objective whilst increasing certainly of cost, the Fund is looking to operate three distinct investment strategies or 'pots', being **Higher, Medium and Low.**

36. The Fund will look to set up principles in relation to the risk management / de-risking strategy and how these run through the asset allocation, the implementation plan and the ongoing governance arrangements by the 1 April 2020. These principles are likely to cover:

- to de-risk only when affordable
- to consider re-risking if necessary
- to take account of market conditions
- to build in protection strategies when appropriate
- to take account of different employer groups
- to retain as much simplicity in implementation as possible
- any changes to asset allocation must be scalable across all groups of employers.

37. The two objectives of maximising returns and stabilising contribution rates can be conflicting (as risk needs to be taken to achieve returns, but risk does not guarantee returns). **The objective of this risk management / de-risking framework is therefore to better reflect the need to protect any future improvements in funding level to ensure a reasonable balance between the two objectives over time.**

38. The current Fund investment strategy will apply to the "higher risk pot" where it is likely that most of our existing Employers will be placed. The "medium risk pot" and "lower risk pot" will give employers the option to reduce the level of investment risk that they wish to take, particularly for those employers that are considering leaving the Fund. In addition, any orphaned liabilities once an employer exits the Fund will generally be moved into the lower risk pot as these liabilities have no sponsoring employer and are ultimately underwritten by all employers within the Fund.

Section 4: Setting the Scene: LGPS Central (Pooling)

39. On 25 November 2015, DCLG published its response to the May 2014 consultation (Opportunities for collaboration, cost savings and efficiencies). It said responsibility for asset allocation would stay with the 90 administering authorities and that savings could be delivered using asset pooling and collective investment vehicles. Worcestershire Pension Fund (WPF) in collaboration with eight other Local Authorities (Cheshire, Leicestershire, Shropshire, Staffordshire, the West Midlands, Derbyshire, Nottinghamshire, and the West Midlands Integrated Transport Authority) set up a collective investment vehicle called LGPS Central the Company was authorised to operate as an Alternative Investment Fund Manager (AIFM) and became formally operational from the 1 April 2018.

40. LGPS Central has been in operation just for 12 months and several local authorities have transitioned some of their existing asset allocations to be managed by the company. WPF transferred its Active Emerging Market Funds to LGPS Central's Global Active Emerging Market on the 1 July 2019 and is anticipated to transfer its active corporate bond fund early in 2020. The total AUM with LGPS Central as at the 31st November 2019 is £334m

41. Hymans highlighted a key consideration of investigating 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. Detailed below in table 3 are a list of products that have recently been developed (*) or are currently being developed.

Table 3 List of products that have recently been developed and planned launch timeline

2019/20	2020/21	2021/22
Corporate Bond Fund	Targeted Return Fund	Sustainable Equities (WMids) *
Private Equity (PE) Vintage Fund *	Infrastructure & Indirect Property	Liability Driven Investments (LDI) Completion
Emerging Market Debt	Small Cap Global Equities Fund	Conventional Fixed Income
Multi Asset Credit	Private Debt	Japanese Equities
Global Active Emerging Markets*	Liability Driven Investments (LDI)	
Factor Based Equities includes All World Global Climate Change*	PE 2020 Vintage	
UK Active Equities		

Section 4: Setting the Scene: Equity Protection

42. An Equity Protection solution was implemented (via River & Mercantile) in February 2018 (covering an 18-month period) focussing on providing downside protection to the Fund's passive UK, U.S. and European equities with a combined market value of c. £1.2bn at that time. This was based on the advice of the actuary primarily to

- Reduce the likelihood that further deficit contributions will be required at the 2019 valuation; and
- Seek to “bank” some of the recent upside with a view to potentially reducing contributions at future valuations

43. At the time alternative approaches to equity protection were considered which would be to simply de-risk by moving funds from equities to other asset classes. The challenge with this approach is that it would also reduce return commensurately which would have an impact on the affordability of providing future benefits

44. As part of a strategy meeting with the Actuary on the 15 May 2019 discussions were held concerning the Equity Protection Strategy. The actuary provided a specific paper on the 'impact of Equity Protection on contributions'. River & Mercantile were in attendance along with the Funds Independent Investment advisor.

45. This emphasised that the Fund had implemented an equity protection strategy as at the 31 March 2018 for a specific reason; to protect from the risk of falls in the investment markets leading to deterioration in the Pension Fund’s funding position with consequent increased contributions at the next valuation.

46. Given the expiry date (September / October 2019), it was felt a good time to review whether the current structure should continue or whether an alternative long-term approach should be adopted. Several potential strategies were considered at the June 19 Pension Committee: -

a) We no longer require the protection strategy, and the options are left to expire and not renewed;
b) The same static strategy is renewed;
c) A different static strategy which offers different downside protection and upside potential is adopted; and
d) A longer-term dynamic strategy is better suited to the Fund's objectives.

47. The paper provided by the Actuary considered these options for several different market scenarios to illustrate the impact competing structures have on contributions. It also provided a more in-depth analysis of the static approach (protection for a certain fixed length of time) and dynamic approach (a longer-term tool to control equity downside risk).

48. The caveat to all this was that the Actuary believes that the Fund could benefit from using an equity protection strategy in terms of providing increased certainty and affordability of contributions if markets were to deteriorate. In discussions it was felt that there were several aspects to consider being: -

a) **The Governance angle** to protect from the risk of increased employer contributions. This would mean extending the current static strategy to around mid-2020 slightly past the formal sign off date for the 2019 actuarial valuation (31 March 2020). As part of this consideration it would be investigated as to whether more upside participation can be implemented over this period without giving up too much downside protection. This would also provide the Actuary certainty that the Equity Protection is in place when the actuary's rates and adjustments certificate must be signed off;
b) **The Risk profile** as technically the Equity Protection strategy does help provide diversification in the portfolio and reduces the risk profile as part of the valuation (admittedly at a cost similar to paying an insurance premium); and
c) **A longer term dynamic strategy.** This needs to be considered as part of the Asset Allocation review that will be conducted from June through to around November 2019 to ascertain whether the Equity Protection Strategy should become an integral part of the Funds future investment strategy.

49. This was discussed and agreed at the June Pensions Committee that:

a) The Equity Protection current static strategy be extended to mid-2020 to protect employer contributions and provide certainty to the Actuary that the Equity Protection is in place when the actuary certificate must be signed off. (**This has been extended to September 2020).**

b) Options be explored as to whether more upside participation can be implemented over this period without giving up too much downside protection be delegated to the Chief Financial Officer in consultation with the Chair of Pensions Committee; **(This was implemented, and details reported to the October Pension Committee)** and.

c) The Equity Protection Strategy be considered as part of the Asset Allocation review that will be conducted from June through to around November 2019 to ascertain as to whether this should become an integral part of the Funds future investment strategy. (see paragraphs 145d)

Section 5: Taking Stock: Summarising the current Strategic Asset Allocation

50. The current long-term strategic asset allocation for the Fund is listed below in Table 4:

Table 4 current long-term strategic asset allocation for the Fund

Asset Allocation	%	Manager, Method & Performance Target
Actively Managed Equities		
Far East Developed	10.0	Nomura Asset Management - FTSE All World Asia Pacific Index + 1.5%
Emerging Markets	10.0	LGPS Central Global emerging markets equity mandates (BMO, UBS and Vontobel split a third each). All World Emerging Market Index +2.0%
Passively Managed Equities - Market Capitalisation Indices		
United Kingdom	23.5	Legal and General Asset Management - FTSE All Share Index
North America	9.0	Legal and General Asset Management - FTSE All World North America - Developed Series Index
Europe ex - UK	7.5	Legal and General Asset Management - FTSE All World Europe ex UK Index - Developed Series Index
Passively Managed Equities – Alternative Indices		
Global	15.0	Legal and General Asset Management: - 40% GPAE - FTSE-RAFI Dev. 1000 Equity Fund - 30% GPBK - MSCI World Mini Volatility Index - 30% STAJ - CSUF - STAJ MF36726/36727
Fixed Income	10.0	- JP Morgan Asset Management - 100% Barclays Global Aggregate Corporate Bond Index – Hedged into GBP - EQT Corporate Private Debt Fund
Property & Infrastructure	15.0	Through a mix of Green Investment Bank, Invesco, Hermes, Walton Street, Venn Partners, AEW, Stonepeak and Firststate,
	100.0	

Section 5: Taking Stock: Overview of the Fund's current investment strategy

51. The current asset allocation has maintained a clear but reduced focus on equity assets, a target of 75%. Equities are recognised as a growth asset class and can be both passively managed (linked to the respective indices) and actively managed. In addition to equities, the Fund targets 15% of the fund's assets to property and alternatives and 10% investment into fixed income.

52. Following the endorsed recommendation, at the 2016 asset allocation review Pension Committee meeting, to transition 5% of the fund's assets from equities to property and alternatives, the fund currently has a commitment of 15% of its assets to a combination of eleven property and infrastructure pooled funds. This helps improves diversification and reduce volatility of returns. However, these types of assets do take time to deploy the capital and this needs to be taken into consideration.

53. The Funds Management Fees for 2019 are just over benchmark cost compared to the LGPS average Fund and to the other members of the LGPS Central pool. Significant work has been carried out over the past few years to negotiate fee discounts with the Fund's active managers and to gain savings through the joint re-procurement of the passive mandate. This will continue through LGPS pooling arrangements. However, management fees may increase as the fund continues to disinvest from low cost passive funds into higher cost Infrastructure and Property funds.

54. The following Table 5 sets out the current Fund asset allocation as compared to the Local Government Pension Scheme average asset allocation as at 31 March 2018 derived from the LGPS universe. This LGPS universe does not differentiate between passive and active management

Table 5: Comparison of Fund against Local Government Pension scheme average

Asset Class	Fund	Local Authority Average*
	%	%
Equities	76.2	57.0
Fixed income	13.6*	17.4
Property	4.9	7.1
Alternatives Infrastructure	3.6	3.6
Cash	0.8	2.2
Private Equity	0.0	4.6
Hedge, Balanced, Global Tactical Allocation Fund, etc & Derivatives	0.9	8.1
	100.0	100.0

*The information for comparison is taken from the CEM Benchmarking Report 2018. Note the Fixed Income includes the Equity Protection as these are shown as Gilt investments used as collateral for the protection strategy

55. After taking the Fund's continuing transition from equities to property and infrastructure into account, the Fund's allocation to Equities as an asset class remains significantly higher than the mean allocation. While this is not necessarily a bad thing while the strategy works, it does expose the Fund to substantially increased volatility in performance when equities are out of favour, as has been seen over recent history.

56. The Fund's liabilities are discounted by a CPI+ methodology, giving more stable liabilities going forwards. Significant volatility in the Fund's asset value will directly impact on the funding level and subsequent recovery plans. The Pensions Committee should note this risk that the Fund holds by having a higher equity allocation exposure than the local authority average. However, the Fund still needs to recover a Funding Deficit in line with its Funding Strategy Statement and continues to take steps to mitigate this risk via the Equity Protection strategy and equity disinvestment into Property and Infrastructure.

57. The Pensions Regulator holds an oversight role for LGPS Funds, and along with GAD and the LGPS Scheme Advisory Board will be monitoring funding levels and recovery plans closely in future years. The five asset classes currently utilised by the Fund are summarised below.

Active equities

To justify the higher cost of management and the greater risk profile, it is reasonable to assume that higher rewards should come from this element. For this to be fully effective it has been expected that appointed managers should have a high level of conviction in their stock selections and therefore be relatively unconstrained within their mandate but demonstrate strong governance and responsible investment.

Passive equities

These investments remove the risk of potential poor performance from active managers. These investments do not remove the impact on fund values from oscillations in the tracked indices. After a period of rising markets with low volatility we have seen an increase in volatility in world markets over the last year or so, this may well continue if fears of a global recession grow and equity markets start to fall..

Fixed Income

Corporate Bonds

A corporate bond is a bond issued by a corporation in order to raise financing for a variety of reasons such as to on-going operations, M&A, or to expand business. The term is usually applied to longer-term debt instruments, with maturity of at least one year.

Corporate Private Debt

Corporate Private debt comprises mezzanine (This type of capital is usually not secured by assets and is lent strictly based on a company's ability to repay the debt from free cash flow) and other forms of **debt** financing that comes mainly from institutional **investors** such as funds and insurance companies – but not from banks. In contrast to publicly listed **corporate** bonds, **private debt instruments** are generally illiquid and not regularly traded on organised markets

Property pooled funds

A Property pooled fund is a type of mutual fund that primarily focuses on investing in securities offered by public real estate companies. Most of real estate funds are invested in commercial and corporate properties, although they also may include investments in raw land, apartment complexes and agricultural space.

Infrastructure pooled funds

Infrastructure can be defined as the essential facilities and services upon which the economic productivity of society depends. These assets are typically involved in the movement of goods, people, water, and energy. Infrastructure returns can be accessed through listed Infrastructure, which is more correlated to Equity returns, unlisted Infrastructure equity investments accessed through pooled funds and Infrastructure Debt, again usually accessed through pooled funds.

Other types of investment that WPF is not yet invested in and why at this time are as follows: -

Multi Asset Credit

Multi- Asset Credit Strategies offer a flexible approach that invests dynamically across a range of credit asset classes. These alternative assets include high yield bonds, bank loans, asset- and mortgage backed securities, emerging market debt and more illiquid opportunities in real estate and infrastructure debt. The Fund has not yet reached the stage were a complex strategy to generate income is required. It is to be hoped that LGPS Central will develop a range of options over time to meet this requirement in a cost-effective manner.

Private Equity and Venture Capital (or unquoted equity)

This is often deemed to be particularly appropriate for pension funds, given the longer-term nature of the investments. Basically, that means that such investments can be illiquid, but to some extent can be addressed by investing in quoted private equity companies. Again, there are different routes to making investments, ranging from direct investment in individual companies to investing in fund of funds (which helps diversify risk). At this stage in the investment cycle Private Equity investments are relatively expensive, with the danger of a deteriorating outlook. This is an attractive area of investment, but it would be preferable to wait until values look more attractive before a programme of investments is initiated. The experienced team at LGPS Central are well placed to provide appropriate advice.

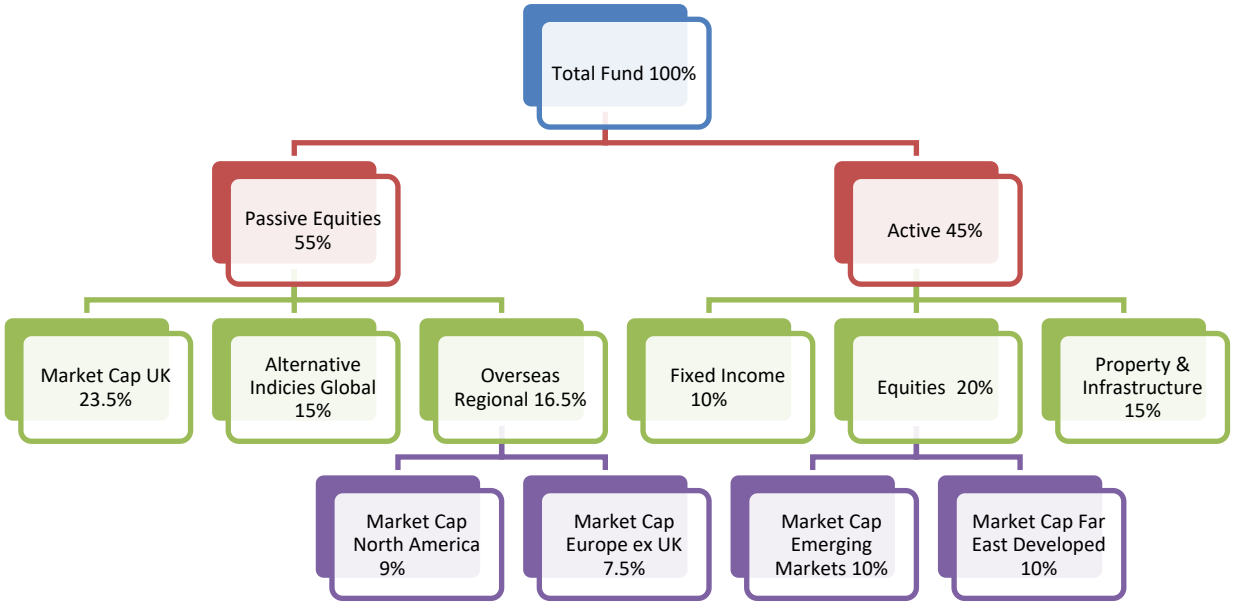
Gilts

Government bonds in the U.K., India, and several other Commonwealth countries are known as gilts. Gilts are the equivalent of U.S. Treasury securities in their respective countries. The term gilt is often used informally to describe any bond that has a very low risk of default and a correspondingly low rate of return. They are called gilts because the original certificates issued by the British government had gilded edges. The Fund switched from Gilts to corporate bonds in 2003 because it was deemed that Gilts looked relatively more expensive than corporate bonds. The impact of quantitative easing has led to a continuing scenario in which Gilts offer very poor value to investors and are mainly held for liability matching purposes.

58. Equities are primarily split on a regional geographic basis, except for the alternative indices allocation in the passive equity portfolio, which is on a global basis. The current allocation is set out in Figure 2 below. Bond investments are in global corporate debt. All active equity indices are 'Market Cap' based, whilst the passive allocation is 'Market Cap' based for the developed regional equity investments and a mix of alternative indices for the global allocation.

59. Over the past three years the Fund has continued to diversify away from the traditional asset classes of equities and bonds, to help achieve a lower risk and volatility profile, alongside seeking additional sources of income and growth. This strategy is in-line with the actions taken by other LGPS Funds. At present the Fund has diversified into property and infrastructure pooled funds and Corporate Private debt.

Figure 2: Current allocation of assets

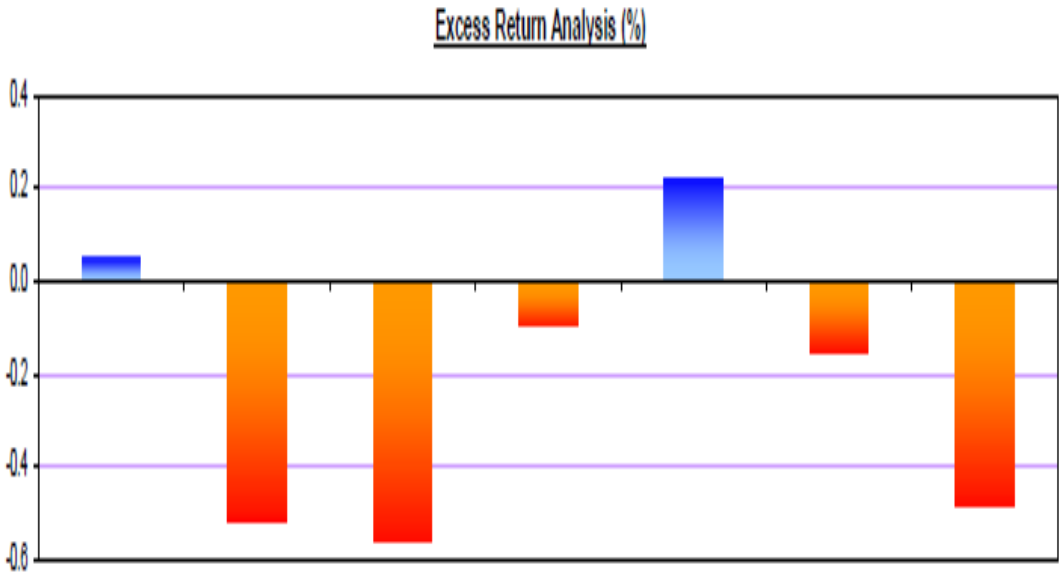


Section 5: Taking Stock: Summary of Fund performance

Fund performance over 1, 3, 5 and 10 years (where applicable)

60. The Fund's performance, as at 30 September 2019, can be analysed against the bespoke benchmark as shown in figure 3 below which reflects the specific assets that the Fund invests in, or against a peer group of other Funds (usually specifically other LGPS Funds). A comparison will be made against other Funds later in this section. Therefore, this will concentrate on performance against the Fund's own benchmark

Figure 3: Summary performance of total Fund against Fund benchmarks



	QTR	YTD	1 Yr	3 Yr	5 Yr	10Yr	Since Mar 87 (p.a.)
Excess Return	0.0	-0.5	-0.6	-0.1	0.2	-0.1	-0.5
Portfolio Return	2.3	6.4	5.7	8.7	9.8	9.1	8.1
Benchmark Return	2.3	6.9	6.3	8.8	9.5	9.2	8.6

All returns for periods in excess of 1 year are annualized. The portfolio return is net.

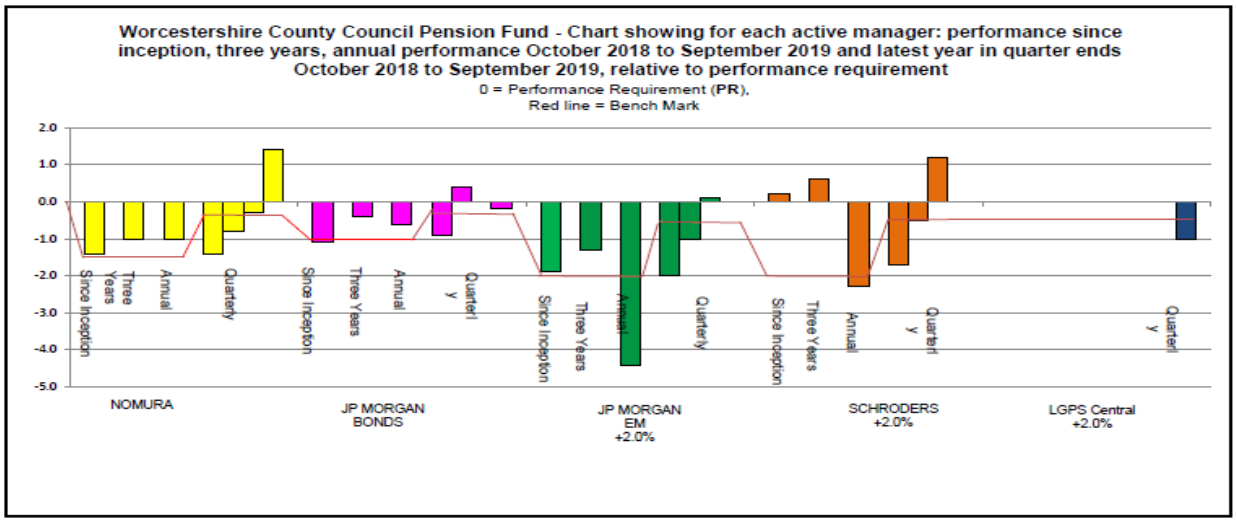
60. Over one year the Fund has underperformed the benchmark by 0.6%, over three years has underperformed by 0.1% per annum and underperformed over the past ten years by 0.1% per annum.

61. The Fund's performance represents a minimal divergence from benchmark and can be explained by the actual high percentage of assets (54%) that are managed on a passive basis. The reversion to passive equity investment that has happened since the last triennial valuation and asset allocation review was made with the intention to reduce the risk of significant underperformance occurring on any timescale. It also recognised that in rising markets it is hard for active managers to outperform general market movements in developed markets, such North America. The slight underperformance illustrated above over the ten-year period is directly attributable to the active managers employed at the time, one of which was relieved of their mandate in 2013. As we enter a market phase that is likely to be more volatile and has an increased risk of values falling, the opportunity for active managers to outperform traditional market capitalisation benchmarks tend to improve.

Investment managers performance

The performance by Fund Manager is illustrated in Figure 4 below

Figure 4: Summary performance by Fund Manager



£1,586.4 million – Passively managed Equities *as at the end of September 19*

62. The passive equities mandate is managed by Legal and General Asset Management (LGIM). The mandate has been held by LGIM since December 2015 following the joint procurement by six Midlands based Funds, five of which are also members of the LGPS Central pool. The joint procurement exercise generated significant fee saving for the six Funds involved and has since been replicated by other LGPS Funds across the country. The mandate covers the UK, Europe ex-UK, North America and a global alternative indices allocation.

63. The passive equity mandate has performed broadly in line with the benchmark, which is as expected and table 6 below shows the performance as at the end of September 19. Therefore, this section on manager performance will concentrate on the Bonds mandate, Active Equity mandates and the Property and Infrastructure investments.

Table 6: Passive Equity Funds performance as at the end of September 19

Asset Class	3 Year Actual	3 Year BM	Since Inception	Since Inception BM
	Return	Return	Return	Return
	% p.a.	% p.a.	% p.a.	% p.a.
Passive				
UK Equity Fund	7.0	6.8	9.8	9.6
North America Equity Fund	15.2	15.1	18.7	18.7
Europe Equity Fund	9.9	10.1	12.4	12.7
Total Passive Equity	**9.9**	**9.5**	**12.9**	**12.3**
Alternatives Factors				
RAFI	10.9	11.0	14.9	15.0
Low Volatility	11.7	11.6	16.9	16.9
Quality	15.3	15.4	18.3	18.4
Total Alternatives	**12.2**	**12.7**	**15.3**	**15.7**
TOTAL FUND All Equities	**9.2**	**9.6**	**13.0**	**13.1**

£914.1 million – Actively managed Equities *as at the end of September 19*

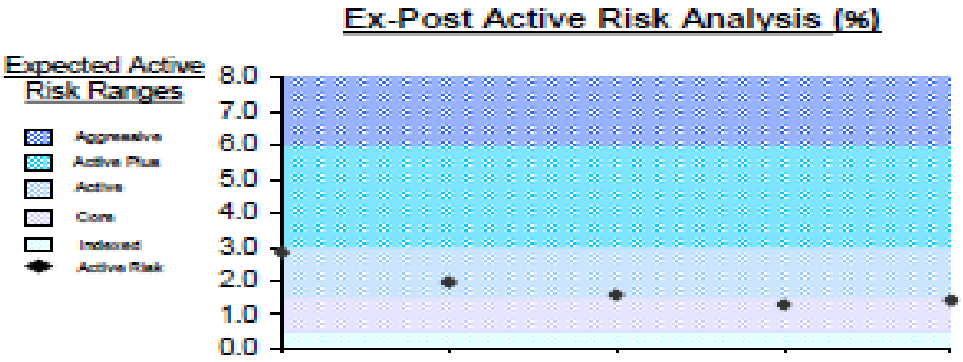
64. The Far East Developed Equities mandate managed by Nomura and the Bonds mandate managed by JP Morgan have been in place for just over thirteen years. The Emerging Markets Equities mandates previously managed by JP Morgan and Schroders had been in place since 2011. These were transitioned across on the 19th July 2019 to the LGPS Global Active Emerging Market mandate split equally to the three-active global emerging markets equity fund managers BMO, UBS and Vontobel within the portfolio.

65. The Far East Developed Equities mandate and the Bonds mandate performed well for the first five years until the financial year 2007/08. Since 2008 the active elements have delivered relatively poor performance relative to target. JP Morgan have struggled with performance on their Emerging Markets mandate, however Schroders performed relatively well since inception apart from last year. Since inception, in absolute annualised returns terms Emerging markets have delivered +8.4%, the Far East has provided +10.5%.

66. Across the life of these mandates performance has been volatile, with many months showing negative returns, which has hampered achieving consistent performance. This volatility is illustrated in the individual manager sections shown in Figure 4 above

67. The amount of risk taken by the active managers is shown in Figure 5 below, which shows how active management adds to total portfolio risk

Figure 5: Ex Post Active Risk Analysis



	1 Yr	3 Yr	5 Yr	10 Yr	Mar 87
Active Risk	2.9	2.0	1.6	1.3	1.4
Portfolio Risk	6.9	6.7	7.9	9.7	12.6
Benchmark Risk	9.3	7.5	8.2	9.6	12.4

68. Table 7 below shows the Active Equities performance as at the end of September 2019 over the past 3 to 5 years respectively and since inception.

Table 7: Active Equities performance as at the end of September 2019

Asset Class	3 Year Actual	3 Year BM	3 Year PBM	5 Year Actual	5 Year BM	5 Year PBM	Since Inception	Since Inception BM	Since Inception PBM
	Return	Return	Return	Return	Return	Return	Return	Return	Return
	% p.a.	% p.a.	% p.a.	% p.a.	% p.a.	% p.a.	% p.a.	% p.a.	% p.a.
Nomura	**8.8**	8.3	9.8	**11.8**	11.1	12.6	**10.5**	10.4	11.9
JPMorgan	**8.9**	9.7	11.7	**9.5**	9.5	11.5	**7.7**	7.8	9.8
Schroders	**11.2**	9.5	11.5	**11.2**	9.5	11.5	**9.1**	7.2	9.2
TOTAL									

£423.1 million – Nomura Asset Mgt UK Limited – Japan and Developed Asia ex-Japan

69. Nomura have underperformed over the last 12 months (against their performance target of 1.5%) by 1.0%, over 3 years by 1.0% (per annum) and since inception (February 2003) by 1.4%.

70. This remains a diverse mandate, covering a lot of territory, which brings considerable challenges in making sure money is invested in the right markets at the right time. For instance, Nomura continue with investment in Australia even though in the long term this has been a persistent negative contributor to the overall portfolio.

71. In broad terms the Japanese element of the mandate has performed better than the rest of the region. Over the last 5 years the Japan element has achieved an annualised return of 13.6% against a benchmark of 12.2% compared to the 9.5% annualised return (same as benchmark) for the rest of the region.

72. LGPS Central has indicated that in their current plans they do not intend to create a Developed Asia sub fund, so consideration about future options for this mandate will be included in the Strategic Asset Allocation review.

JP Morgan Asset Mgt – Emerging Markets (transitioned to LGPS Central 19th July 2019

73. JP Morgan had underperformed over the last 12 months (against their 2% per annum performance target) by 2.4% and since inception (12/12/2011) underperformed against their performance benchmark by 2.1% per annum.

Schroder Investment Management Limited – Emerging Markets (transitioned to LGPS Central 19th July 2019

74. Schroders had outperformed (against their 2% per annum performance target) over 12 months by 0.6% but have underperformed since inception (20/10/2011) by 0.1% per annum.

75. Schroders performance has tended to be quite volatile at times. Over time they stuck with their strategies and was rewarded. Schroders provided some exposure to Frontier Markets, thus extending the geographical spread for the Fund.

£336.2 million LGPS Central Global Active Emerging Market as at September 2019

76. Performance objective is to outperform the benchmark by 2.0% annually over rolling 5 years. This has started off with an underperformance of -0.04% (-3.24% v. -3.20%) since inception on 19 July 2019. This will be closely scrutinised, and the Fund will have more of an opportunity to compare leaders and laggards with three managers, compared to just looking at our previous managers JP Morgan and Schroders

Fixed income investments

77. This covers our JP Morgan Bond Investment and our recent Corporate Private Debt Mandate with EQT

£154.8 million - JP Morgan Asset Management - Bonds as at September 2019

78. JP Morgan have underperformed (against their 1% per annum performance target) over the past 12 months by 0.6% and have underperformed over the last 3 years per annum by 0.5%. Since inception (31/3/03) they are behind target by 0.3% per annum.

79. The transition of this mandate to LGPS Central's appointed managers (Fidelity and Neuberger Berman) for Global Investment Grade Corporate Bonds after robust due diligence was agreed by Pensions Investment Sub Committee on the 11th June 2019. This has been postponed until early 2020, due to concerns about potential market volatility during the transition process.

80. Since inception the cumulative return has been disappointing. Initial returns were positive, but then tailed off sharply in late 2007/2008. There was subsequently a gradual improvement, particularly following the changes made to the mandate in 2009 and 2012 but performance has remained below target. Concerns were consistently challenged that JP Morgan had not utilised their risk budget effectively to achieve their performance target and this continues despite changes in manager.

£13.8 million – EQT Corporate Private Debt Fund as at September 2019

81. A report to Invest Panel on the 28 March 2019 which was subsequently agreed by Pensions committee identified that the Fund at that time had an actual allocation to fixed income of 6% (SAA target of 10%) via a segregated account with JP Morgan Asset Management and as such was under-allocated by c. 4% (c. £110m) relative to the strategic asset allocation target. The c. 4% underweight position was due to the Fund's equities outperforming corporate bonds and an active decision not to rebalance the weights to these asset classes. The Fund was therefore overweight to equities due to the underweight position in corporate bonds.

82. Taking into consideration the improved funding position and the Committee's decision at that time to implement an equity protection strategy it was recommended and agreed that the overweight position to equities was reduced and alternative investment options considered.

83. Bfinance were asked to consider the underweight position to Corporate Bonds and assess alternative investment options outside of Bonds given the Interest rate and market environment at that time and still presently prevails. Bfinance recommend that in the current market environment, corporate private debt offers an attractive risk adjusted return with strong downside protection and yield. Further details regarding corporate private debt vehicles were provided to the Committee in December 2017.

84. BFinance then undertook a portfolio design of the proposed investments in terms of style, size and geographic exposure along with analysis of proposals from interested managers and preparation of a report to select a short list of suitable specialists capable of managing the mandate successfully and EQT were appointed in May 2018 with a commitment of £65m.

85. The Funds Investment Strategy Statement was also amended to include fixed income investments (change from Bonds to Fixed income) such as corporate debt vehicles as this is in line with the Funds objectives and beliefs.

86. The latest EQT performance against the agreed benchmark showed an outperformance of 5.0% over the quarter (6.6% v. 1.6%). The latest valuation data for EQT is for Q2 2019, the period ending 30 June. As at the end of July, the Fund's portfolio comprised of investments in 16 companies, representing approximately 61% of total commitments. Amount drawn less recallable distributions: £14.4m (€16.8m) as at 30th June 2019 against the £65m commitment.

£418.6million Property & Infrastructure as at September 2019

87. Over the past three years the Fund has continued to diversify away from the traditional asset classes of equities and bonds, to help achieve a lower risk and volatility profile, alongside seeking additional sources of income and growth. This strategy has been in-line with the actions taken by other LGPS Funds. This is set to continue over the medium term following the Strategic Asset Allocation day in September 2019 with other partner funds and LGPS Central particularly given the improved actuarial funding positions.

88. At present the Fund has diversified into property and infrastructure pooled funds and Corporate Private debt, which by their nature have more inherent protections against future inflationary pressures and historically have been less volatile in terms of valuation than Equities. However, flexibility is also required when investing in Infrastructure and Property funds, as drawdown periods can be lengthy, and a programme of rolling reinvestment will require time to fully implement efficiently

Management fee

89. The 2019 CEM Benchmarking showed that our investment cost of 46.8 bps was above our benchmark cost of 46.2 bps. CEM commented that the cost increase was due entirely to asset mix changes, primarily adding more property and infrastructure. This was offset by decreases in what we paid for the UK stock, global property and infrastructure. Whilst work continues to look at fee savings via LGPS pooling arrangements, Committee need to be mindful that some of these savings may in fact be offset as the fund continues to disinvest from low cost passive funds into higher cost Infrastructure and Property funds

90. The current performance against the benchmark as at the end of September 2019 is detailed in table 8 below. At this time the fund had £176.5m (6.0% of the fund) in pooled property and £242.1m (8.3% of the fund) in infrastructure against an overall Property & Infrastructure SAA target of 15%.

Table 8: current performance against the benchmark as at the end of September 2019

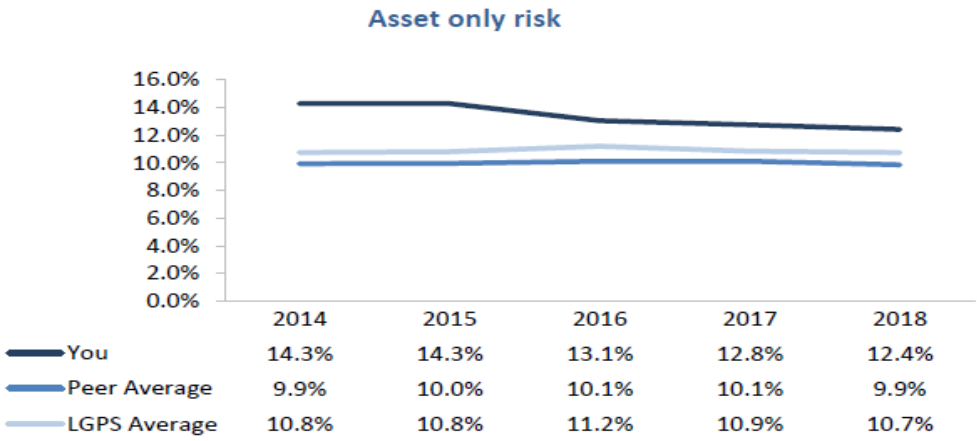
Asset Class	1 Year Actual	1-year Benchmark Return	3 Year Actual	3 Year Benchmark	Since Inception Actual	Since Inception Benchmark
	Return	Return	Return	Return	Return	Return
	%	%	% p.a.	% p.a.	% p.a.	% p.a.
Pooled Property	4.6	7.1	6.9	7.1	8.2	7.1
Pooled Infrastructure	5.1	4.3	8.1	8.7	7.3	8.2

Section 5: Taking Stock: Comparison with the asset risk of other LGPS Funds

Asset Risk Trends 2014 to 2018

91. Figure 6 below provides the asset risk being the expected volatility of our asset mix compared to the LGPS universe for 2018. Asset risk will only change if policy asset mix changes. Between 2014 and 2018 the asset risk of WPF decreased from 14.3% to 12.4%. This remained above our peers due to the funding position and recovery plan accepted by the Committee in 2016.

Figure 6: Asset risk being the expected volatility of our asset mix compared to the LGPS universe

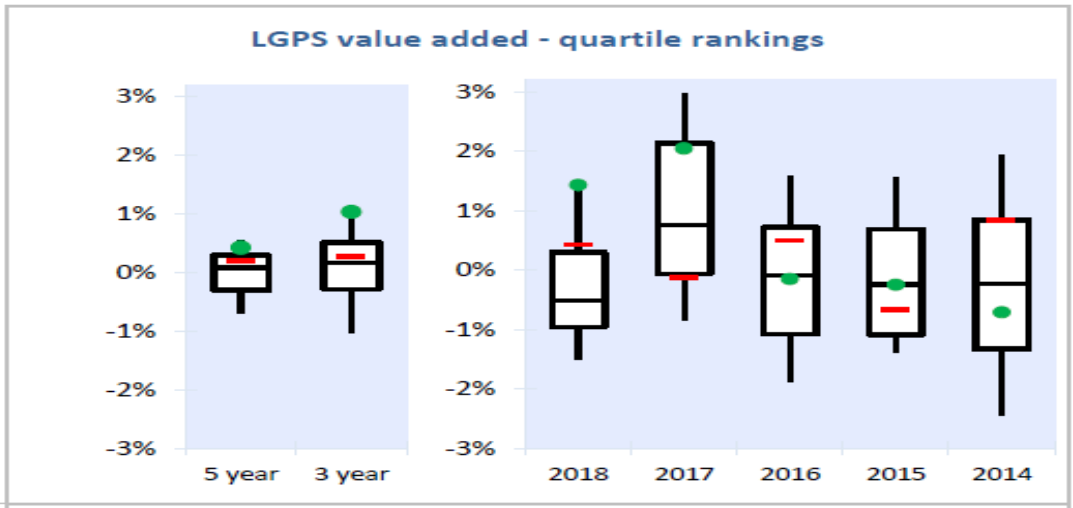


*The information for comparison is taken from the CEM Benchmarking Report 2018. **Note 'You' = WPF**

92. This will be mainly due to our diversification of assets into Infrastructure and Property and the reduction in our passive portfolio over time. This is still 1.7% above the LGPS average which shows our appetite to risk to increase our funding levels.

93. Figure 7 below shows the 'Net value-added component of total returns from active management It equals the total net returns minus the strategic asset mix return. It is a function of active management decisions which includes tactical asset allocation, manager selection, stock selection, choice of benchmarks, overlays, etc. The Funds 5 – year net value added of 0.4% compares to a median of 0.1% for the LGPS Universe.

Figure 7: Net value-added component of total returns from active management



LGPS							
90th	0.6	1.0	1.4	3.0	1.6	1.6	1.9
Q3	0.3	0.5	0.3	2.1	0.7	0.7	0.8
Median	0.1	0.2	-0.5	0.8	-0.1	-0.2	-0.2
Q1	-0.3	-0.3	-1.0	-0.1	-1.1	-1.1	-1.3
10th	-0.7	-1.0	-1.5	-0.8	-1.9	-1.4	-2.4
Average	0.0	0.1	-0.2	0.9	-0.2	-0.2	-0.1
Global Median	0.2	0.3	0.4	-0.1	0.5	-0.7	0.8
Your fund	0.4	1.0	1.4	2.0	-0.1	-0.2	-0.7
LGPS %ile	83%	91%	90%	73%	47%	48%	36%

*The information for comparison is taken from the CEM Benchmarking Report 2018

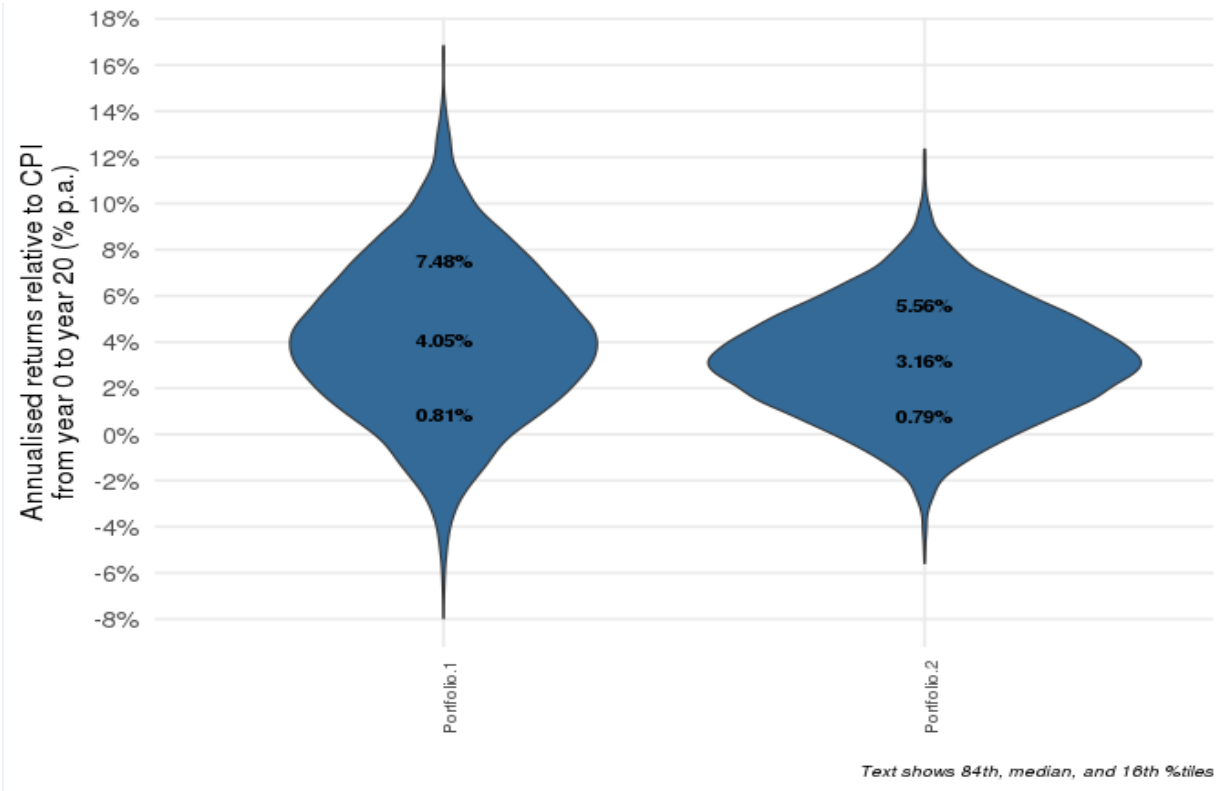
Section 6: Review of the Fund's Strategic Asset Allocation

Risk analysis - High Level Risk and return analysis

94. Hymans Robertson provided some high-level risk and return analysis. The modelling that they undertook allowed them to look at the expected return against liabilities and associated volatility of a variety of different investment strategies. It also allowed them to show how each mandate contributes to the total risk within the portfolio.

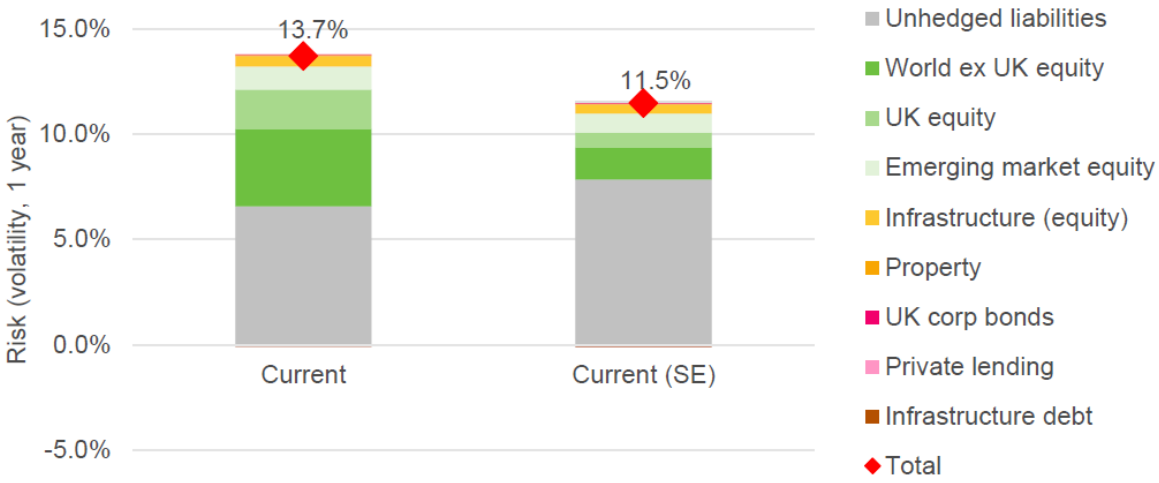
95. The chart below shows expected returns relative to CPI inflation based on Hymans Robertson Long-term capital markets assumptions within their report presented to Committee in March 2019. The Fund's expected return assumptions and valuation discount rate is derived relative to CPI. Both expected returns exceed the underlying valuation assumption of CPI+ 2.15% p.a. and CPI +2.75% p.a. for past and future service respectively.

Figure 8: Expected returns relative to CPI (with and without structured equity arrangement)



96. Figure 9: 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

Figure 9: Risk contribution (with and without structured equity arrangement)



97. Whilst the yield risk of the un-hedged liabilities is large (the grey section of the chart) Hymans viewed 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.

Section 7: A review of Equities Structures

Global Based Mandates

98. These mandates are popular as asset managers strive to concentrate their attentions on markets with the best prospects, wherever they are, developed, emerging or even frontier. However, the scale of operations needed to support a global investment manager usually means that their focus tends to be on larger, more tradable company names, meaning that there are plenty of opportunities for regional specialists to identify smaller, less well-known companies with good long-term prospects for their investors.

99. Out of the main market areas (USA, Europe, Far East and Emerging Markets); in the medium-term Emerging Markets and the Far East probably continue to have the best potential upside. However, after a long period in which equity investors have seen excellent returns on their portfolios, some caution should now be considered prudent as we appear to be entering a period of uncertain global growth. It is within this more uncertain environment that active developed market managers can more readily outperform passive benchmarks, as investors become more focused on individual company prospects.

Far East and Emerging Markets

100. It is important to focus on the relative attractions of the various parts of the region to ensure that the Fund has exposure to the most attractive areas. The mandate with Nomura is focused purely on Japan and Developed Asia ex-Japan and is designed to complement the exposure to Asia within the separate Emerging Markets mandate, the management of which is now overseen by LGPS Central. The underlying managers are BMO, Vontobel and UBS.

101. The fee discount for the Developed Asia portfolio remains in place with Nomura until target returns are achieved over a rolling three-year period. The Japanese element has generally shown satisfactory performance over time. However, the ex-Japan element has always struggled to produce a consistently above target performance record. The original mandate with Nomura initiated in 2003, so it would now be appropriate to review our management arrangements, including considering the separation of the Japan and ex Japan elements into discreet mandates.

102. Emerging Markets as a group have had a volatile period over the last few years. As always with such a diverse range of factors influencing individual markets, including the oil price, currency issues, trade worries and geopolitical events, it can be difficult for asset managers to produce consistently good returns against such a background.

North America

103. The U.S. stock markets have seen almost unprecedented gains since the election of Donald Trump as President. His background in business, rather than politics, has certainly shaped his economic policy with the direct intention of boosting US internal trade and industry and markets have responded accordingly.

104. Our underweight position in the U.S. is in part due to the belief that such a developed market would struggle to outperform more vibrant and developing economies. The decision not to continue with active management of this portfolio was determined by the lack of conviction that active managers could add value over a passive mandate. While the U.S. market is at a level at which it would be difficult to justify increasing the weighting at this time, consideration should be given to doing this if circumstances present an appropriate opportunity in the future. Market conditions at that time might be such that active management is considered again, at least in part.

Europe

105. It continues to be very difficult to construct a consistently good case for a positive stance to Europe. It is a challenge to see what course of events will trigger a substantial and sustainable recovery in most of the Eurozone, given the sheer scale of sovereign debt and continuing potential banking issues, on top of increased political volatility. The post Brexit scenario will be challenging, on both sides of the Channel.

UK

106. In relative valuation terms the UK market looks attractive in comparison to other developed markets, but this situation has been brought about by uncertainties about the global trading environment in a post Brexit scenario. Although there is likely to be a period of considerable readjustment so far as our trading partners are concerned, once the outlook becomes clearer then it is possible that the UK stock markets will rally. However, volatility is likely to remain, and many uncertainties will persist for the foreseeable future.

Conclusion

107. After a long period in which equity investors have seen excellent returns on their portfolios, some caution should now be considered prudent as we appear to be entering a period of uncertain global growth. It is within this more uncertain environment that active developed market managers can more readily outperform passive benchmarks, as investors become more focused on individual company prospects

Review of Active versus passive Equities

Recap of Hymans view

108. Hymans highlighted that having a well-defined set of investment beliefs offers several advantages to the Committee including clarity of rationale for each mandate held within the Fund inconsistency 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 Funds asset allocation, bringing liquidity, transparency and reducing fee levels

109. Table 9 below sets out the Funds current mandates and whether these are managed on an active or passive basis

Table 9: Fund current mandates

Mandate	Target Allocation	Active / Passive
Far East Developed	10%	Active
Emerging Markets	10%	Active
Global Equities	**55%**	**Passive**
Market Cap	40%	
Alternative Factors		
RAFI	6%	
Low Volatility	4.5%	
Quality	4.5%	
Total Equities	**75%**	**20% / 55%**
Fixed Interest	10%	Active
Alternatives (Property & Infrastructure)	15%	Active

110. Around 45% of the Funds mandate are managed on an Active basis at total fund level and around 25% of the target equity allocation is managed actively. Active management at the moment is employed only in the emerging markets and far east regions in the belief that these regions are less efficient relative to other global regions

111. Hymans highlighted that the long-term track record of active equity managers within the LGPS sector has generally been disappointing pointing out that based on statistics to March 2016. They did add that relative performance will vary over time as similar statistics from 5 years ago show a track record of no added value from the average UK equity manager but 1.2% outperformance from overseas managers. The key requirement therefore suggested by Hymans was the ability to identify in advance an above- average manager

Conclusion

112. Hymans believed there is a role for an allocation to passive equities as part of an overall equity allocation which was reflected in their own beliefs due to the low risk and low fee benefits. They believed that active management should only be considered where the Committee believes it adds value.

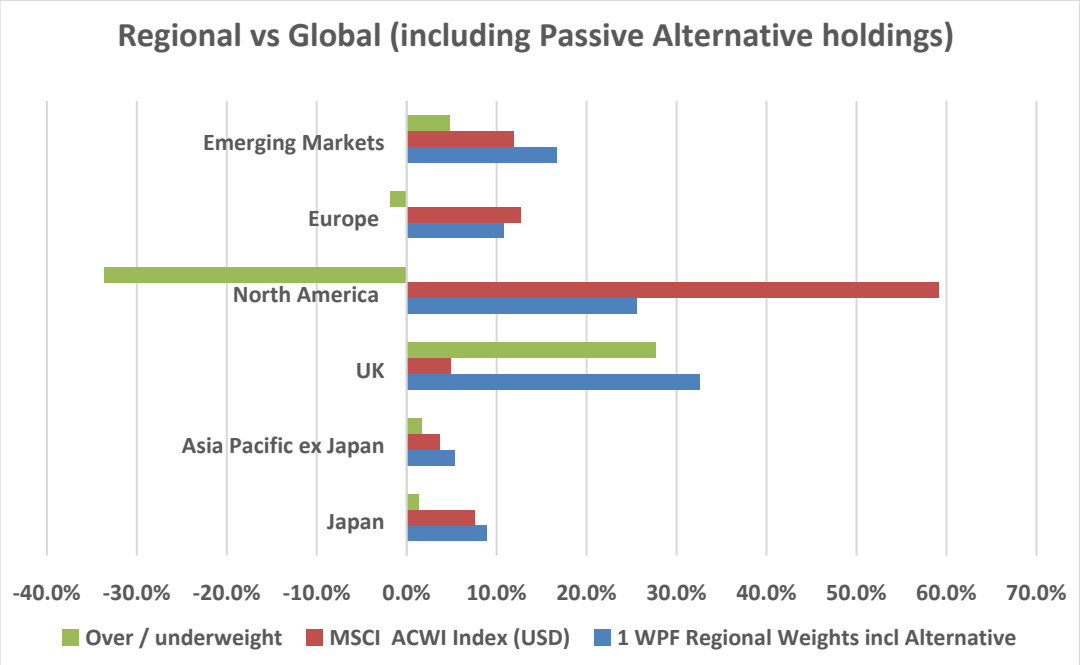
113. Another consideration is that we have seen generally less volatility in world markets over the last decade until quite recently. Volatility is likely to increase if we enter into a bear market phase. This may then be a time for consideration that selective active management may add more value to the portfolio in these circumstances, as active managers have more opportunities to produce differentiated strategies in less "perfect" market conditions.

Review of Regional weights compared to global index

114. Equities are primarily split on a regional geographic basis, except for the alternative indices allocation in the passive equity portfolio, which is on a global basis. All active equity indices are 'Market Cap' based, whilst the passive allocation is 'Market Cap' based for the developed regional equity investments and a mix of alternative indices for the global allocation

115. Figure 10 below sets out the Fund's equity exposure via regional portfolios relative to the MSCI All Country World Index (ACWI).

Figure 10: Funds equity exposure via regional portfolios to the MSCI ACWI



116. Compared to the MSCI All Country World Index the Fund has a significant underweight to North America, a significant overweight to the UK. Over the long term the process of determining regional weights is likely to be a major driver of the Fund's equity allocations performance. Table 10 below shows the performance of the two regions to which the Fund had material deviations relative to the global standard benchmark over one year, three years and five years to September 2019.

Table 10: Regional performance

Region	Index	1 Year	3 Years (p.a.)	5 Years (p.a.)
North America	S&P 500 (USD)	8.47	12.24	9.31
UK	FTSE 100 (GBP)	2.68	6.76	6.79

117. Over the past five years North America has performed very strongly compared to the UK. Therefore, over this shorter time horizon allocating to equities on a global basis would have been optimal for Funding the short-term valuations of the UK market relative to the US have been depressed, due to uncertainties surrounding Brexit with the associated political issues and US valuations being boosted by a favourable tax regime. In due course it would be appropriate to seek to rebalance these weightings, but timing will be important.

118. Performance of regional vs. global allocations will fluctuate over time but investing via a series of regional weightings does offer the Fund better opportunities to fully tailor regional weights and provides the option of dynamic asset allocation by the Pension

119. Table 11 below sets out the benefits of a regional and global approach to equities asset allocation

Table 11: benefits of a regional and global approach to equities asset allocation

Regional Equity Portfolios	Global Equity Portfolios
- Easy to fully express customised regional tilts;	- Delegation of regional tilts to managers;
- May benefit from specialist regional managers;	- Managers have full flexibility of global stock universe.
- Domestic allocation tax/local knowledge benefits;	- Global managers now have meaningful track records;
- Appropriate resourcing required for implementation.	- Easy implementation of global equity exposure.

Conclusion

120. There is no clear case to move from regional allocation of equities to global currently. Global exposure is also gained through the Fund's passive alternative indices allocation, so in reality the Fund employs a mixed approach to equities asset allocation

121. To implement the proposed 5% strategic target allocation to Property & Infrastructure it is proposed to reduce 5% of the Passive equity market cap indices pro-rated equally across the previous allocation. The optimum reduction will be reviewed, and the outcome reported to a future Pensions Investment Sub Committee

123. It is also recommended that a review of regional equity weightings be carried out in particular the allocation to UK and US equities. A regular review of regional equity weightings is recommended to form part of a more dynamic approach to asset allocation undertaken by the Pension Investment Sub Committee.

Review of active Emerging Markets managers

124. As described in paragraph 64 the Emerging Markets Equities mandates previously managed by JP Morgan and Schroders since 2011 were transitioned across on the 19 July 2019 to the LGPS Central Global Active Emerging Market mandate. The WPF investment was split equally to the three-active global emerging markets equity fund managers BMO, UBS and Vontobel within the portfolio.

125. In the due diligence that had been undertaken and reported to the Investment Sub Committee on the 11 June 2019, it was noted that these were 'stock pickers' but all assess the opportunity differently. The style analysis on the 3 fund managers was more or less neutral apart from a slight bias to quality. The multi manager approach should help achieve diversification of alpha sources (measure of the active return on an investment)

Conclusion

126. It is recommended that the Pension Investment Sub Committee continue to monitor closely the Emerging Markets portfolio as part of the regular review of the overall asset allocation.

Review of Nomura – Developed Far East equities

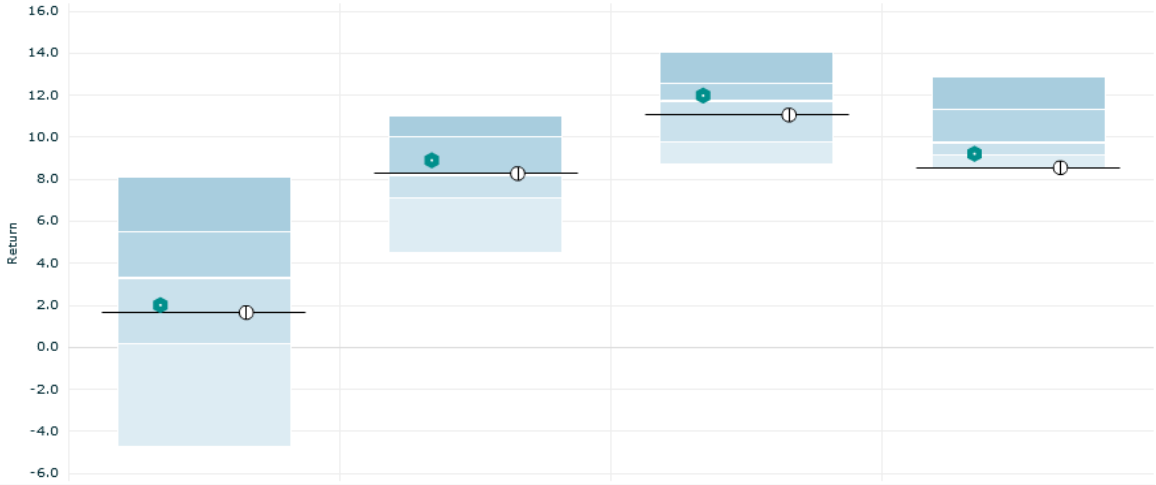
127. Figure 10 below has been provided by Mercers to evidence their performance compared to peers for various periods over the past ten years. The analysis has been run from the Mercer Insight database.

Figure 11 Nomura comparison to their Peers

Worcestershire - Nomura

Return in GBP (before fees) over 1 yr, 3 yrs, 5 yrs, 10 yrs ending September-19

Comparison with the Asia Pacific inc Japan Equity universe (Actual Ranking)



	1 yr (%)	3 yrs (%pa)	5 yrs (%pa)	10 yrs (%pa)
PB inc Japan	2.0 *(19)*	8.9 *(10)*	12.0 *(10)*	9.2 *(16)*
FTSE AW AP	1.7 *(20)*	8.3 *(13)*	11.1 *(14)*	8.5 *(20)*
95th Percentile	8.1	11.0	14.1	12.9
Upper Quartile	5.5	10.0	12.6	11.4
Median	3.3	8.2	11.7	9.8
Lower Quartile	0.2	7.1	9.8	9.2
5th Percentile	-4.7	4.5	8.7	8.5
Number	28	25	24	21

Created on 27 Nov 2019 at 2:07 PM

MERCER

PB inc Japan = Nomura mandate

128. The analysis shows that the 3-year and 5-year return are above median, and the 1-year and 10-year returns are below the median.

Conclusion

129. It is best practice to review active manager arrangements from time to time to ensure that the Fund is still employing the best managers for the selected mandates.

130. From the peer group evidence provided the Fund doesn't currently contract best in class active managers but neither do we have the lowest performing. There is significant manager selection risk involved with trying to select the best in class managers, with manager performance rotation an issue over the short term. It should be noted that our Emerging Markets mandate has now transitioned to LGPS Central, with Corporate Bonds due to follow shortly. We will be monitoring the performance of their appointed managers closely. This just leaves our Developed Asian Markets outstanding, the options for which are listed below.

131. As detailed in paragraphs 71 above the Japanese element of the mandate has performed better than the rest of the region. Given this mandate has been in place since 2003 and that LGPS Central have indicated in their current plans they do not intend to create a Developed Asia sub fund it is recommended to explore several potential options as follows: -

- Maintain the mandate as is but potentially retender
- maintaining the Japan element only and disinvest from the Far East developed which would include an assessment on the impact on the regional coverage of the Fund
- Discuss further with LGPS Central their plans and advice for funds in this area

Review of the passive equities alternative indices blend Passive equities investment strategies

132. Passive investment removes active manager risk, but the investor is still exposed to the full impact of market volatility, which can have a profound impact on Fund values when markets fall sharply. The Fund currently gains exposure to passive equities through the following two different types of indices:

a) Regional Market capitalisation weighted Indices

A capitalisation-weighted index is a type of market index with individual components that are weighted according to their total market capitalisation. The larger components carry higher percentage weightings, while the smaller components in the index have lower weights.

b) Global Alternative Indices

A set of investment strategies that emphasise the use of alternative index construction rules to traditional market capitalisation-based indices. Alternative indices emphasise capturing investment factors or market inefficiencies in a rules-based and transparent way. The aim is to remove some of the market driven volatility from the measurement process.

133. 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;

- Most 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

134. 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.

135. Hymans believed 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. Hymans believed 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;

136. 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 as detailed below.

- **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.

- **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

137. 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. Currently we do not invest in this area although LGPS Central are currently looking to develop a small companies passive investment mandate for consideration.

138. Table 6 in paragraph 63 above details the performance to date of the 'alternative passive factors and have outperformed the passive factors in terms of annualised returns

139. The alternative indices blend has provided additional diversification as intended at the point of implementation and due to market environment has provided additional return since 2013.

Hymans view recap

140. Hymans liked 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. Alternative indices performance vs market capitalisation indices

Conclusion

141. The passive alternative indices have added additional returns and reduced volatility compared to market capitalisation indices.

142. It is not recommended to increase the Fund's allocation to alternative indices at this stage but that further analysis be carried out by Fund officers with the support of Legal and General Asset Management to consider whether the current style of 40% RAFI, 30% quality and 30% low volatility is optimal and explore alternative strategies.

Section 7: Review of Equity Protection (EP) Strategy

143. As described in paragraph 46 there is a need to consider whether the whether the Equity Protection Strategy should become an integral part of the Funds future investment strategy. Hymans recommended that several points needed to be addressed when considering this as follows: -

144. 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?

i. This has successfully been renegotiated and extended through to September/October 2020 and additional upside has been gained whilst maintain downside protection.

145. 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?

a) LGPS Central were asked to undertake a review of our EP strategy and were asked if this should continue and if there are alternative strategies that could be implemented. Their objective was to provide a view on the benefit/risks of making equity protection part of a longer-term strategy within their Strategic Asset Allocation and to consider alternatives with the aim of maintaining employer contribution rates at the same level.

b) Their conclusion was *in Summary LGPSC believe that as a short to medium Risk Management tool equity protection strategies can work well, provided they are managed dynamically and supported by appropriate controls/tools. But, due to the requirement of managing it dynamically to sufficiently mitigate the return uncertainty, there is an impact through costs which may make the equity protection not suitable to be integrated as a long-term strategy in the Fund's Investment Strategy.*

c) From a funding perspective 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

d) Discussions on the 14th November 2019 with River and Mercantile and the Chair of the Pensions Committee and Investment Sub Committee discussed in detail how the Equity Protection strategy can be managed dynamically to help mitigate the impact on expected returns. It was agreed to: -

   a. Use the EP strategy as a tool to manage and mitigate the risk of having still a relative high equity exposure to other similar sized funds but review regularly and update at Investment Sub Committee.
   b. Agree trigger points were discussions should take place to discuss if any action such as restructuring or even exiting the Equity Protection strategy and
   c. That Fund Officers with the support of the Fund's Investment advisor closely monitor the existing strategy and bring back more detailed information on how the strategy has performed at least on a quarterly basis to Pensions Investment Sub Committee.

e) The delegated powers are in place already should action need to be taken. It should be noted that the Equity Protection can be exited at any time if as part of the ongoing Strategic asset allocation discussions it is felt that the strategy is no longer required or alternative strategies can achieve the same level of risk mitigation.

146. 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?

a) As well as providing protection and mitigating risk to the Funds passive equity market cap investments a key element was to help protect and stabilise employer's contributions. Through negotiations on the 2019 actuarial valuation with the Funds actuary, Mercers the extension of the Equity Protection strategy has enabled employer contributions to be circa £5m to £10m less per annum so £15m t0 £30m over the lifetime of the valuation period. In net terms allowing for fees £0.5m pa and any cost of restructuring re transaction costs which are estimated to be between 5 and 15bps so mid-point say £1m, then net employer contributions reductions would be circa £3.5m to £8.5m pa

Section 9: Review of FIXED INCOME

Review of the Bond portfolio and Corporate Private Debt Portfolio

Global Investment Grade Corporate Bond

147. Details of the current JPMorgan bond portfolio and the transition of this mandate to LGPS Central's appointed managers (Fidelity and Neuberger Berman) which is due to take place early 2020 is detailed in 78 to 80 above.

148. The Pool corporate bond fund has an active +0.80% target (1% previously with JP Morgan) and 50% UK, 50% overseas benchmark. This strategically fits in with our current Fixed Income allocation.

149. Some of the key reasons for the investment into LGPS Central Global Investment Grade Corporate Bond after robust due diligence were: -

- Lower performance fees
- Better comparable performance compared to current portfolio with JP Morgan (*although past performance is no guarantee of future performance*)
- Better diversification when compared to UK Investment grade corporate bonds
- Opportunities to benefit from market anomalies – different spreads in different markets for the same issuer

Investment strategy

150. This is currently an outlier in terms of portfolio risk compared to LGPS average and therefore it is recommended to maintain the current global corporate Bonds strategy and transition this to the LGPS Central Global Investment Grade Corporate Bond. Maintaining a small investment to Government Bonds in the short to medium term is also logical given the current market environment.

Conclusion

151. It is recommended to maintain the Funds current global corporate bonds strategy and transition the existing JP Morgan mandate to the LGPS Central Global Investment Grade Corporate Bond as previously agreed at Investment Sub Committee on the 11th June 2019.

Review of EQT Corporate Private Debt Fund

152. In paragraph 83 above a report to Pensions Committee in March 2018 highlighted that Bfinance were asked to consider the underweight position to Corporate Bonds and assess alternative investment options outside of Bonds given the Interest rate and market environment at that time and still presently prevails. Bfinance recommend that in the current market environment, corporate private debt offers an attractive risk adjusted return with strong downside protection and yield. This resulted in a commitment of £65m to EQT.

153. Hymans Robertson in their SAA report to Committee in March 2019 were favourable of investment in Private Debt. They commented as follows: -

154. 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.

155. Several 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.

156. We believe private debt can provide 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.

157. 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.

Conclusion

158. Both Bfinance and more recently Hymans believe private debt can provide strong growth but with reduced market-to-market volatility, more transparency and prefer the visibility of return through contractual income offered by private debt opportunities.

159. It is therefore recommended to maintain the current strategic asset allocation target at 10% and invest any existing underweight into suitable Fixed Income Products such as Private Debt. Further dialogue will be undertaken with LGPS Central to assess whether they are looking at suitable debt vehicles, if not the Fund will look to invest further outside of the pooling arrangements.

Section 10: Review of the Fund's exposure to currency

160. There exists the potential for the Fund to be impacted by rising inflation and currency movements. As part of the review of potential risks to the Fund's assets and returns, an assessment of the potential impact of an increase in inflation and substantial movements in key currencies has been undertaken.

161. Mitigating the impact of currency movements can be considerably more complicated, but again this is a potential key risk when investing in non-Sterling assets, at both the asset level and to interest payments. The usual arrangement would be to hedge against the impact of adverse currency movements, but as this comes at a cost it would need to be considered as part of the investment assessment. Some Funds use their custodian to arrange currency hedging on a passive basis; others have employed managers to hedge currency exposures in a more dynamic process.

162. Table 12 shows how 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

Table12: 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

163. Most 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 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 most of the primary currency risk.

Currency hedging

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

Hymans comments and overall view

165. Hymans commented that 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.

165. 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.

166. 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.

167. 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 increased equity return volatility.

Hymans view

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

169. Therefore, they did 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 (*current Investment Strategy belief detailed below*) and some of the considerations set out above.

2018 Investment Strategy belief extract

170. The Fund is aware that investing in overseas equities introduces an element of currency risk, but given the level of diversification within the Fund, the Pensions Committee is comfortable taking this risk in general but may act to mitigate potentially significant risks as and when they are identified.

Conclusion

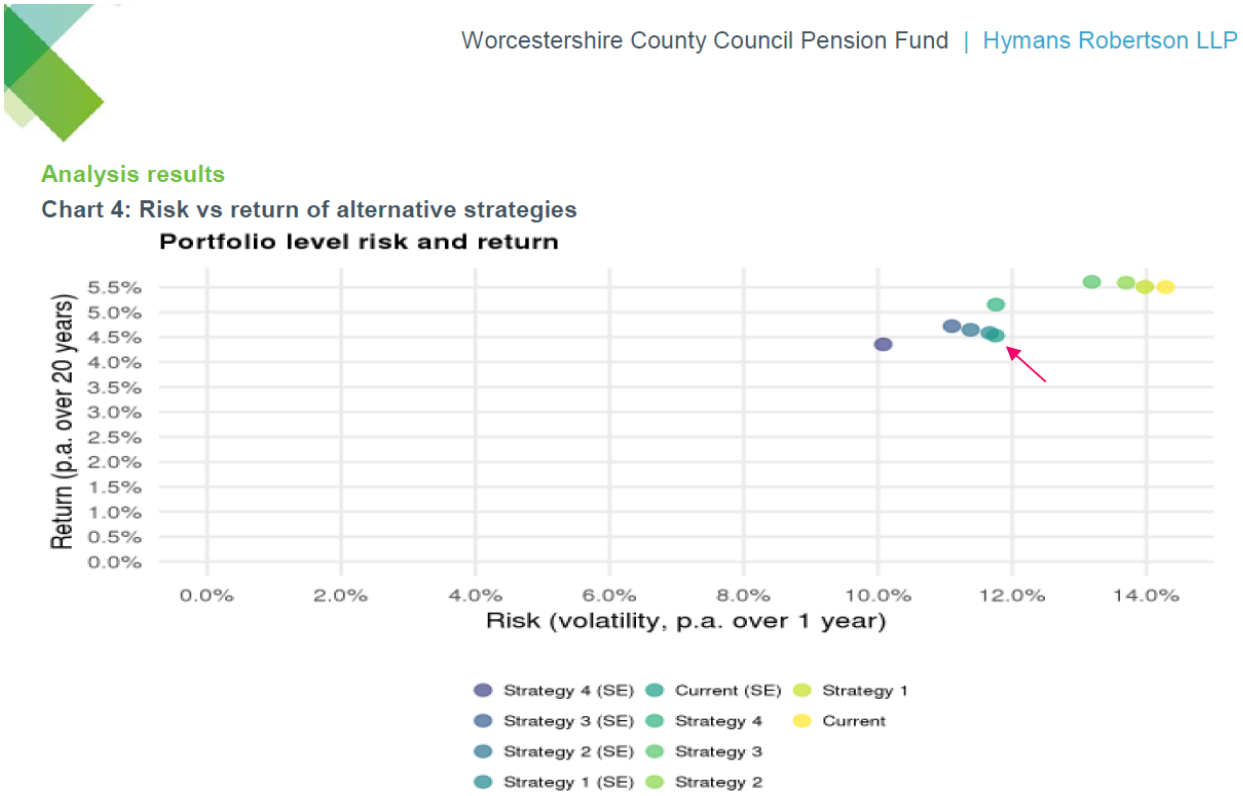
171. It is recommended that the Fund's equities remain unhedged in terms of currency at least until the Brexit negotiations are finalised, as this is likely to be a continuing volatile period for Sterling. The decision of whether to currency hedge overseas equities should be kept under review by the Pension Committee at least annually.

Section 11: Review of the Property and Infrastructure Allocation Current allocation to Infrastructure and Real Estate

Investment Risk in terms of volatility and impact on returns of moving 5% from Equities to Property & Infrastructure

172. It is worth revisiting the alternative strategies that were highlighted in Hymans report that 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. This is shown in Figure 12 below: -

Figure 12: Risk vs return of alternative strategies



173. The Fund's current proposed strategy (70% Equities, 20% Property & Infrastructure and 10% Fixed Income) including the impact of a rolling structured equity arrangement (before this was restructured to allow more upside) is highlighted by the **pink arrow**. This showed a risk volatility per annum over 1 year of just under 12% and an average return per annum of around 4.5%. Hymans highlighted that without the structured equity in place this strategy would have an increased volatility risk to 14% but increased average returns of 5.5%. The analysis showed: -

a) 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.
b) The impact of a rolling structured equity arrangement is expected to reduce both the volatility and expected returns of the Fund's assets.
c) The Fund could afford to de-risk to strategy 4 (55% Equities, 15% Property & Infrastructure and 30% Fixed Income) and still have a higher expected return and reduced volatility than the current investment strategy with the structured equity overlay.

However, Hymans commented that the market outlook for lower risk assets like gilts was not particularly appealing and recommended that the Fund should not 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

d) 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.

174. Hymans were supportive of the current programme to build up the allocation to property and infrastructure as diversifying, income focussed assets

Conclusion

175. Increased allocation to Infrastructure, Real Estate or a combination of each is expected to maintain expected return, reduce risk / volatility and add continue to offer some inflation hedge to the overall portfolio.

176. It is recommended that a 5% increased allocation (overall from 15% to 20%) to Infrastructure is implemented or a mix of Infrastructure and Real Estate. It is recommended that the 5% be transitioned from the Fund's passive market cap Equity allocation.

177. Continue "rolling" the investment programme either from follow on funds from existing fund managers or suitable alternative fund managers to reinvest distributions and to provide a spread over "vintage" years. Hopefully this will also enable investments to be made as attractive opportunities occur, when valuations in sub sectors look particularly attractive.

178. A review of the funds resources is undertaken to ensure the appointment and monitoring of the investments is manageable given the Fund's current resources.

Section 12: Review of the Funds Net Cashflow Requirements

179. The Fund is currently marginally cashflow negative due to several 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.

180. 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.£180m of undrawn commitments within the property and infrastructure portfolio and is currently disinvesting from equities as and when required to meet capital calls.

181. The Fund monitors its cashflow daily and looks to forecast ahead the inflows and outflows including the potential investment capital drawdowns (based on information from its fund managers) over a 12 to 18-month period.

182. Table 13 below shows the Cashflow over the past 4 years and the forecast for 2019.20 and 2020-21.

Table 13: Cashflow over the past 4 years and the forecast for 2019.20 and 2020-21

Cashflow Management	20-21 £'M	19-20 £'M	18-19 £'M	17-18 £'M	16-17 £'M	15-16 £'M
Contributions receivable	112.5*	101.0	81.8	185.2	107.8	104.3
Benefits Payable	-120.0	-113.2	-106.3	-98.0	-95.5	-93.9
Net Cashflow before investment income - surplus / deficit (-)	**-7.5**	**-12.2**	**-24.5**	**87.2**	**12.3**	**10.4**
Investment income *(**)*	43.0	43.5	51.7	35.8	29.4	38.1
Net Cashflow	**35.5**	**31.3**	**27.2**	**123.0**	**41.7**	**48.5**

Note

** This is an estimate of the contributions to be received and is dependent on which investment 'pot' employers are placed and also if employers decide to prepay.*

*** The Investment Income includes equity dividends which are reinvested. In 2018.19 around £26m of the £51.7m related to direct cash income from some of our Property and Infrastructure investments to aid cashflow*

183. It is proposed to continue to use the Infrastructure & Property assets and explore potentially some alternative type of credit assets as suggested within the Hymans report such as multi asset credit and private debt (existing allocation already with EQT) to aid future income generation. These assets are attractive for the level of income they provide but also the predictability and stability of returns.

184. The Fund currently has no strategic allocation to cash and chooses to keep the amount of cash held within the Fund very low 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.

Re-balancing and liquidity waterfall

185. 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 it is proposed to establish a formal re-balancing policy and liquidity waterfall framework.

186. The Committee currently monitors the Fund's investment strategy relative to the agreed strategic benchmark against the ranges in table 14 below. If ranges are breached, then appropriate discussions / debates take place and where necessary action is taken by the Chief Financial Officer

Table 14: Rebalancing Ranges

Asset Type	Strategic Target (%)	Range (%)
Equities	75	70 - 80
Fixed income	10	5 - 15
Infrastructure & Property	15	10 - 20

187. It is proposed to establish a high-level liquidity waterfall for accessing cash should it be required to fund any future investments or to pay member benefits and discuss this at the next Pensions Investment Sub Committee. An illustration of this is shown below in Appendix 2.

Section 13: Responsible Investment, Climate Change and impact investing

188. The list of reasons to invest responsibly is growing. Building a better society and protecting the planet by funding companies that treat employees with respect, conserve water and reduce climate- damaging carbon emissions is a motivation for many.

189. The growing body of research claiming that these strategies not only reduce risk, but investors do not have to sacrifice return by adopting them is another attraction.

190. A Responsible Investment (RI) or an Environmental Social Governance (ESG) investment (properly conceived) is not an asset class or sub-asset class with 30 years of history of returns data. It can be conceived of as a style within an asset class, for example within equities a sustainable approach can offer style diversification, though there is typically some overlap with the Quality style. Quality is typically useful to investors in late cycle. More universally, good ESG integration can be seen simply as good portfolio management, an indication of superior investment processes.

191. Climate change can be thought of as a risk factor and depending on Pension Committee views play a part in the asset allocation strategy. For example, Mercer's modelling of asset class returns has been augmented to consider the ways in which physical climate risks (extreme weather events, sea level rise, etc) and transition risks (technological substitution, carbon prices/ taxes, policy shifts, etc) could affect different asset classes and different sectors. LGPS Central are to provide a Climate Risk Reports to our Fund early in 2020 and will be a convenient time to take stock and assess any further action required

- Climate scenario analysis across all our asset classes
- Carbon Metric scorecard to identify our carbon footprint
- A Climate stewardship plan

Impact investing

192. Impact investing has gained a lot of traction in the past 18 months. Recently regulatory language (e.g. DWP new Statement of Investment Principles (SIP) regulations, pressure to consider beneficiaries, or the MHCLG wording on “social investment”) has paved the way for inflows into impact strategies. Again, certain fund managers have used the 17 Sustainable Development Goals (SDG’s) to productise an impact investment fund, i.e. by targeting specific development goals and intentionally seeking to invest such that a financial return, and an impact in that SDG goal obtain. SDG 2019 Report

193. It remains a challenge to fit impact investing into existing models of asset allocation. It does not appear to be a standalone asset class and, therefore we do not see asset allocators carving (for example) 5% of their allocation (though there are some exceptions). Impact strategies are available in most major asset classes (listed equities, private equity, corporate bonds, infrastructure), **and from an asset allocation it appears to us preferable to think about impact strategies within this well-established asset classes rather than as a standalone bucket.**

194. The fund already actively invests in green energy through a £52m investment in offshore wind farms through Green Investment Bank and investments in solar energy and onshore wind farms through a £46m investment in Hermes Infrastructure Fund. However, several funds have been recently developed or are in the process of being developed by LGPS Central such as

- A Sustainable Equities Framework has been instigated by West Midlands Pensions Fund with support from LGPS Central and 5 differing funds are available for future investment. Worcestershire Pension Fund was involved in the due diligence on these funds.
- The case for investing in Global Smaller Companies; and
- The case for a 2% performance capped active UK benchmark.
- Low Carbon Multi Factor sub-fund (Now launched)

195. The Fund should look closely at these and consider if they fit in or are a suitable investment as part of our SAA Framework

196. Additional specific training for Committee and Pension Board members is being provided on the 13 December. In addition, we are looking to enhance our current Investment Strategy Statement concerning Responsible Investment which will come to the March 2020 Pensions Committee for approval. A draft extract is as follows: -

Core Principle

We will use an evidence-based long-term investment appraisal to inform decision-making in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.

Associated Actions

- The Fund will consider the potential financial impact of ESG related issues on an ongoing basis (e.g. climate change or executive remuneration).
- The Fund will consider the potential financial impact of investment opportunities that arise from ESG related factors (e.g. investment in renewable energies or housing infrastructure).
- The Fund will consider investment opportunities that have positive impacts and recognises that the changing external environment presents new opportunities i.e. Renewable energy and social impact investments

197. The Fund's current approach to managing these issues is set out in the Investment Strategy Statement (ISS)[1], which contains the following under Investment Beliefs:

> ***"- Effective management of financially material Environmental, Social and Governance (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";***
>
> and the following under Responsible Investment (RI):
>
> **"With regard to climate change risks, the Fund recognises that the scale of the potential impacts is such that a proactive and precautionary approach is needed to address them**

Conclusions

198. From an asset allocation perspective, it would be preferable to think about impact and RI strategies within well-established asset classes rather than as a standalone bucket.

199. The Investment Strategy Statement needs refreshing and will reflect the core principle in 196 above

200. Further work on this area would be required once the LGPS Central provide the Climate Risk Reports early next year and additional specific training for Committee and Pension Board members is being provided on the 13th December 2019.

Supporting Information

Appendix 1: Hymans Robertson and the key findings of the report which were reported to Pension Committee in March 2019
Appendix 2: Proposed high-level liquidity waterfall for accessing cash

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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 report:
2016 Asset Allocation Review December 2016 Pensions Committee and the Hymans Robertson Strategy Review report to Pensions Committee in March 2019:

Appendix 1

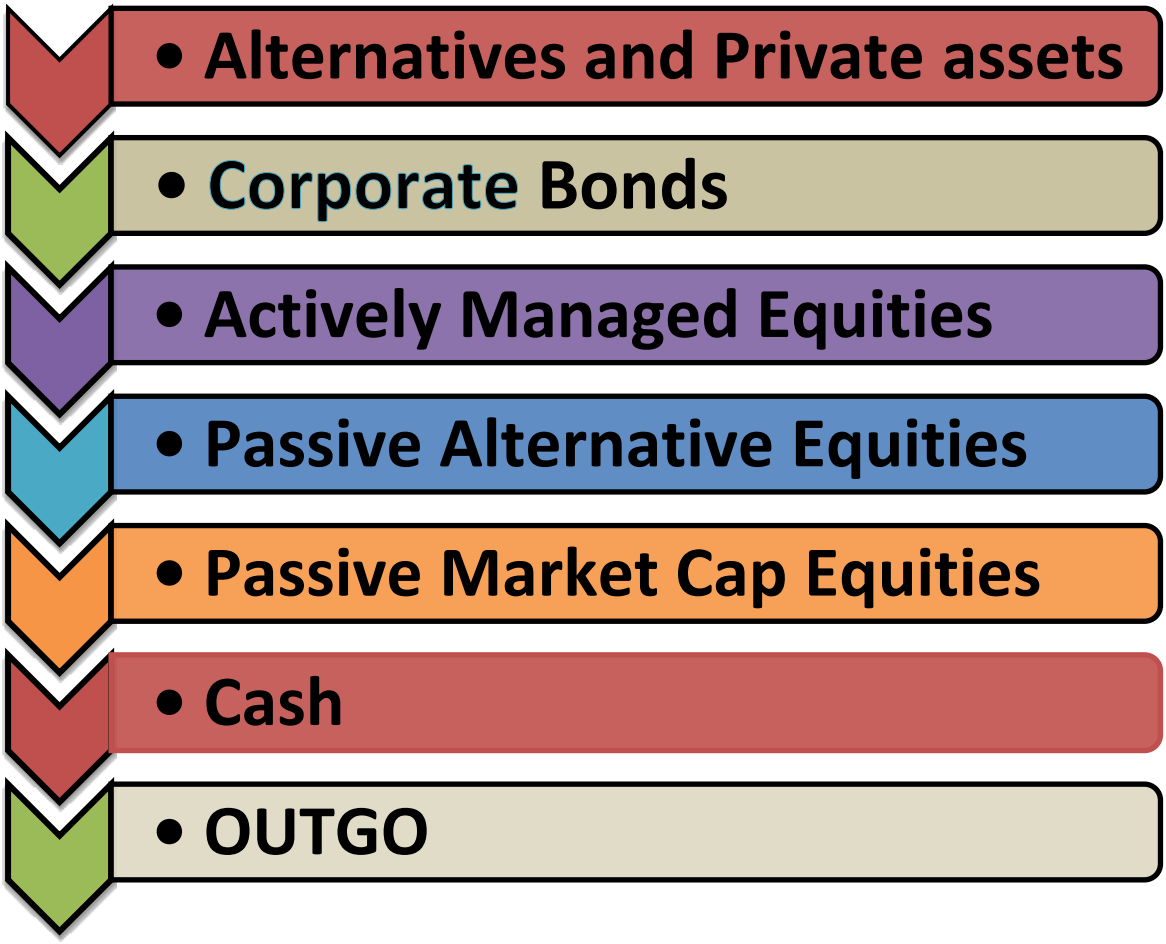
Hymans Robertson and the key findings of the report which were reported to Pension Committee in March 2019

- *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. (See Section 8 of this report)*
- *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. (See Section 9 of this report)*
- *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. (See Section 11 of this report)*
- *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: (See Section 8 of this report)*
    - *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. (See paragraph 33 to 38 of this report)*
- *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. (See Section 10 of this report)*
- *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. (See Section 12 of this report)*
- *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. (see paragraphs 108 to 113 of this report)*

- *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. (see paragraphs 132 to 142 of this report)*
- *The Committee will also need to engage with the Central pool to understand what equity style options will be offered within the pool. (see Section 4.13 to 4.15 of this report)*
- *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. (See Section 10 of this report)*
- *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. (see paragraphs 39 to 41 of this report)*
- *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 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. (See Section 7 of this report)*
- *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. (This will form part of the Investment Strategy Statement review)*
- *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*

Appendix 2

Proposed high-level liquidity waterfall for accessing cash



a) Should access to funds be required instantly this should be sourced from the Funds most liquid asset, ideally cash.
b) If cash is unavailable funds should then be sourced from the next most liquid asset, passive market cap equities.
c) 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 remain sufficiently liquid assets to meet Fund outgo.

The parameters around such a waterfall structure should be determined by the Pensions Investment Sub Committee, considering the Fund's specific objectives and circumstances.

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AGENDA ITEM 8

PENSIONS COMMITTEE
13 DECEMBER 2019

GOOD GOVERNANCE REVIEWS AND OBJECTIVES OF THE FUND'S INVESTMENT ADVISOR

Recommendations

1. **The Chief Financial Officer recommends that the Scheme Advisory Board (SAB) and The Pension Regulator's (TPR) governance reviews and the objectives of the Fund's Investment Advisor be referred to the Pension Board for consideration with the outcomes bought to the Committee meeting in March 2020.**

Background

2. At the last Pensions Committee, a report was provided on Governance. It was highlighted that strong governance of the Pension Fund has always been paramount, and with the collapse of several private sector funds, alongside the set-up of the pension pools and pressures to maintain balanced funds the need to maintain the strong governance of LGPSs has never been more important.

3. Because of this level of inspection there have been two reviews by the Scheme Advisory Board (SAB) and the Pension Regulator looking at how to strengthen governance. This previous report highlighted the findings from those reviews and set out a proposal to strengthen the Pension Board as a first step which was agreed.

4. It was also agreed that:

   a) A further report be brought back to the December Pensions Committee benchmarking the Fund and administration of the Fund against the Scheme Advisory Board and Pension Regulator's governance reviews, with recommendations to further strengthen the Fund;

   b) Objectives for the Fund's Advisor be brought back to the next Pensions Committee for review and approval

5. Since the last Committee the announcement of the General Election and delay in some of the follow up reports have meant there is a slight delay in some of the requirements and guidance. As such, it is felt that these should be first reviewed and discussed at the Pensions Board in February 2020 and the outcomes bought back to the March Pension Committee for further discussion and agreement

Scheme Advisory Board Guidance

6. The last Committee detailed the review undertaken by Hymans Robertson who were appointed by the Scheme Advisory Board (SAB) to facilitate a review of governance structures for the LGPS. The SAB commissioned this report to examine the effectiveness of current LGPS governance models and to consider alternatives or enhancements to existing models which can strengthen LGPS governance.

7. The SAB agreed to take forward Hymans Robertson's findings and conclusions to improve governance in the LGPS, and released the report for publication in July. download the full report here.

8. The key proposals were:

- **An 'Outcomes-based approach** to LGPS governance with minimum standards rather than a prescribed governance model. Critical features of the 'outcomes based' model should include:

    a) robust conflict management including clarity on roles and responsibilities for decision-making
    b) assurance on sufficiency of administration and other resources (quantity and competency) and appropriate budget;
    c) explanation of policy on employer and scheme member engagement and representation in governance; and
    d) regular independent review of governance - this should be based on an enhanced governance compliance statement which should explain how the required outcomes are delivered.

- **Enhanced training requirements** for s151sand s101 committee members (requirements for s101 should be on a par with LPB members)

- **Update relevant guidance and better sign-posting**. This should include 2014 CIPFA guidance for s151s on LGPS 2014 CIPFA guidance for s151s on LGPS responsibilities and 2008 statutory guidance on governance compliance statements. This guidance pre-dates both TPR involvement in LGPS oversight, local pension boards and LGPS investment pooling.

9. SAB agreed that following publication of the report, the Secretariat should commence work, in conjunction with scheme stakeholders, to outline the practical steps necessary to implement the main options set out in the report for consideration by the Board in November. Once approved, scheme stakeholders will be given the opportunity to comment on the Board's recommendations before any formal approach is made to MHCLG Ministers for changes to the scheme's regulations or guidance. The outcomes from the review are detailed in Appendix 1 and a benchmark of how our Fund compares to the practices recommended by SAB will be discussed at the Pension Board in February 2020 and then presented to the March Pensions Committee.

The Pensions Regulator (TPR)

10. In addition to the work being undertaken by the SAB, TPR also published its report in September 2019 into the governance and administration risks in public service pension schemes, including the 10 UK local government funds who were engaged with between October 2018 and July 2019. The key findings were reported to the October Committee.

11. The key areas of focus that were covered with the findings and recommendations, together with case studies were as follows and these will be considered alongside the SAB governance review being discussed at the Pensions Board:

- Record keeping
- Internal Controls
- Administrators
- Member Communication
- Internal Dispute Resolution Procedure
- Pension Boards
- Employers and contributions
- Cyber Security
- Internal Fraud and false claims

Competition and Markets authority (CMA) order on Fiduciary management and Investment consultants

12. At the last Committee On 10 June the Competition and Markets authority (CMA) published the Investment Consultancy and Fiduciary Management Market Investigation order 2019. In summary, the Order defines the Fiduciary Management (FM) services and obliges pension schemes to formally tender for such services. It also obliges pensions schemes to set objectives for their Investment consultancy (IC) providers as well as placing a variety of new obligations on FM and IC service providers.

13. It potentially had consequences for LGPS pools, however on the 29 July the DWP published a consultation on regulations to enact the provisions of the CMA order which explicitly rules out the LGPS as falling under the scope of the obligations in relation to FM service providers. The requirement to set objectives for IC providers remains with a deadline for doing so of 12 December 2019.

14. On the 31 July 2019 The TPR published guidance on the implementation of the CMA order which similarly reflects the position that the LGPS is within the scope only of the IC strategic objectives requirements. Administering authorities should take note of the DWP consultation and the TPR's guide "Setting Objectives for the Provider of Investment Consultant Services. IC Objectives Guide. This may result in WPF setting up formal objectives for its Investment consultancy advisor. Part of the TPR's guidance states the following:

- Setting objectives for advisers is an important part of an effective system of governance. We expect that by putting objectives in place, trustees will be better positioned to assess the quality of the service they receive and to deliver better outcomes for their members
- In setting objectives for your investment adviser, you will want to receive their input to ensure that the objectives being set are consistent with the service being offered and are realistic. In obtaining your adviser's input, you should be aware of the potential for their input to be subject to conflicts of interest and you should be prepared to challenge their input. You should also consider whether to involve a third party to help you set those objectives
- Once objectives have been agreed, we would expect these to be signed off in accordance with your existing governance framework, ensuring that all members of the trustee board have sight of and, if relevant, agree with the adviser objectives that have been set and the ongoing monitoring process of these.

15. The draft proposed formal objectives are detailed in Appendix 2 and the key performance indicators and outcomes are currently being discussed and agreed with the Funds Independent Financial Advisor and will be presented to the February Pensions Board.

16. Members of the Committee should note that the agreed objectives will still be able to be measured and reported retrospectively from the 12 December 2019 deadline.

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Supporting Information

- Appendix 1 – SAB Governance Principles
- Appendix 2 – Proposed Fund Investment Advisor Objectives

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:

16 October 2019 – Pension Committee Agenda paper on Governance.

Scheme Advisory Board Good Governance Proposals
A. **General**
A1. MCHLG will produce statutory guidance to establish new government requirements for fund to effectively implement the proposals below. ("the Guidance")
A2. Each administering authority must have a single named officer who is responsible for the delivery of all LGPS related activity for the fund ('the LGPS senior Officer')
A3. Each administering authority must publish an annual governance compliance statement that sets out how they comply with the governance requirements for LGPS fund as set out in the Guidance. This statement must be signed by the LGPS senior officer and where different co-signed by the S151 Officer.
B. Conflicts of Interest
B1. Each Fund must produce and publish a conflicts of interest policy which includes details of how actual, potential and perceived conflicts are addressed within the governance of the fund, including reference to key conflicts identified in the guidance
B2. The guidance should refer to all those involved in the management of the LGPS and in particular those on decision making committees, to the guide on statutory and fiduciary duty which will be produced by the SAB
C. Representation
C1. Each fund must produce and publish policy on the representation of scheme members and non-administering authority employers on its committees, explaining its approach to representation and voting rights for each party
D. **Knowledge and Understanding**
D1. Introduce a requirement in the Guidance for the key individuals within the LGPS, including LGPS Officers and pensions committee members to have the appropriate level of knowledge and understanding to carry out their duties effectively
D2. Introduce a requirement for s151 officers to carry out LGPS relevant training as part of their CPD requirements to ensure good levels of knowledge and understanding
D3. Administering authorities must publish a policy setting out their approach to the delivery, assessment and recording of training plans to meet these requirements
D4. CIPFA and other relevant professional bodies should be asked to produce appropriate guidance and training modules for S151 officers to consider including LGPS training within their training qualification syllabus
E. Service Delivery for the LGPS Function
E1. Each administering authority must document key roles and responsibilities relating to its LGPS fund and publish roles and responsibilities matrix showing how key decisions are reached. The matrix should reflect the host authority's scheme of delegation and constitution to be consistent with the descriptions and business processes
E2. Each administering authority must report the fund's performance against an agreed set of indicators designed to measure standards of the service.
E3. Each authority must publish and administration strategy
E4. Each administering authority must ensure their committee included in the business planning process. Both the committee and LGPS senior officer must be satisfied with the resource and budget allocated to deliver the LGPS service over the next financial year

Scheme Advisory Board Good Governance Proposals
E5. Each administering authority must give proper consideration to the utilisation of pay and recruitment policies, including appropriate market supplements, relevant to the needs of their pensions function. Administering authorities should not simply apply general council staffing policies such as recruitment freezes to the pensions function
F. Compliance and improvement
F1. Each administering authority must undergo a biennial independent Governance Review and if applicable produce the required improvement plan to address and issues identified. IGR reports to be assessed by a SAB panel of experts
F2. LGA to consider establishing a peer review process for LGPS Funds

Appendix 2

Proposed objectives for Worcestershire Pension Fund Investment Advisor

Task	KPI / Outcome to be determined
A. Provide qualitative general advice to the fund on markets, RI, risk and strategies that have no direct monetary decisions but shape the Fund's thinking at relevant Pension Committee, Investment Sub Committee, local pension board (as required) and meetings with Officers.	
B. Monitoring the Fund's portfolios and considering and providing general advice on the desirability of retaining particular classes of assets or of changing them.	
C. Provide advice that leads to direct cost making decisions regarding: 1. the appointment and dismissal of Fund Managers and our Pool and other Advisers.	
2. as requested on specific proposals which are submitted to the Adviser for this purpose.	
3. Any other matter relating to decisions which directly influence decision making that generates financial cost to the Fund.	
4. oversight of the relationship between the fund and the pool, ensuring what the pool offers complies with strong transition, sound governance and the requirements of the fund and remains so.	
D. Support the fund in training, through transparent general advice.	

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AGENDA ITEM 9

PENSIONS COMMITTEE
13 DECEMBER 2019

LOCAL GOVERNMENT PENSION SCHEME (LGPS) CENTRAL UPDATE

Recommendation

1. **The Chief Financial Officer recommends that the LGPS Central Update be noted.**

Background

2. The government set out in 2014 its approach and reasoning (Opportunities for collaboration, cost savings and efficiencies) for asset pooling with responsibility for asset allocation staying with the 90 administering authorities. Worcestershire Pension Fund (WPF) in collaboration with eight other Local Authorities (Cheshire, Leicestershire, Shropshire, Staffordshire, the West Midlands, Derbyshire, Nottinghamshire, and the West Midlands Integrated Transport Authority) set up a collective investment vehicles called LGPS Central. The Company was authorised to operate as an Alternative Investment Fund Manager (AIFM) and became formally operational from the 1 April 2018.

3. LGPS Central has been in operation just over 20 months and a number of the local authorities have transitioned some of their existing asset allocations to be managed by the company. WPF transferred its Active Emerging Market funds into the LGPS Central's Global Active Emerging Market managed mandate in July 2019.

Transition of Assets

4. The next planned fund to transition across is the Corporate Bonds mandate which has been detailed within the Pensions Investment update on this agenda..

LGPS Central Draft Strategic Business Plan & proposed budget for 2020/21.

5. This was received from the company on the 13 November 2019. Very initial feedback has been provided and the Finance Working Group are meeting LGPS representatives to discuss this in more detail on the 6th December. This will also include the updated cost sharing model and impact for each individual partner fund. This is planned to be formally discussed and presented at the Pensions Committee on the 31 January 2020.

Staffing

6. The Chief Executive of LGPS Central, Mike Weston attended the Pensions Committee on the 16 October 2019 to present the finding of his first 100 days as Chief Executive. Mike answered a series of questions at the Committee which were formally minuted.

7. The Equities Investment Director has recently resigned and there have been some changes to the Lead Portfolio Manager for the Global Equity Multi-Manager Fund which we are invested in. Assurances were sought at the Investment Sub Committee to ensure that the performance monitoring of the fund was taking place appropriately and at a level we expected.

Shareholder and LGPSC Annual General Meeting 1 November 2019

8. This meeting was attended by each individual shareholder representative of the partner funds. Councillor Colin Greatorex from Staffordshire was appointed the new chairman which was previously Councillor Adrian Hardman. The Shareholders meeting mainly covered an Officer briefing and Forum discussion on the LGPS Central Limited AGM Resolutions that had been proposed for the meeting later in the afternoon. These were all subsequently agreed, and the minutes of the meeting will be made available as soon as they have been finalised.

PAF Working Groups

9. 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 are

- Client Oversight and Governance Group
- Investment Working Group
- Responsible Investment Working Group
- Finance Working Group

10. Considerable focus continues to be placed on the client agreements that LGPS Central need to have in place as these are still outstanding as well as developing fund performance reports in a format that the partner funds require.

11. 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.

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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.
- Minutes of the Pensions Committee on the 16 October 2019
- Minutes of the Shareholders meeting on the 1st November 2019

PENSIONS COMMITTEE
13 DECEMBER 2019

PENSION INVESTMENT UPDATE

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 transition of the Active Corporate Bonds mandate into the LGPS 'Global active Investment Grade Corporate Bond Fund be noted;**

   d) **The funding position compared to the investment performance be noted;**

   e) **The update on the Equity Protection current static strategy extension be noted;**

   f) **The update on Responsible Investment activities (Appendix 4) and Stewardship investment pooling and the Stewardship code be noted;**

   g) **The update on the LGPS Central report on the voting undertaken on the Funds behalf be noted (Appendices 5 to 7); and**

   h) **The update on the development of a Climate Risk Monitoring Platform be noted.**

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 Sub Committee (Appendix 1).

JP Morgan Corporate Bond

4. As we head towards the transition of this mandate to LGPS Central's appointed managers (Fidelity and Neuberger Berman), JP Morgan have shown an outperformance of 0.1% (2.4% v 2.3%) in Q3 2019 against their benchmark. Their performance against benchmark over the last 12 months has deteriorated slightly at 0.4% (10.1% v 9.7%), however that is still behind their performance target by 0.5% over three years and 0.3% over the 10 years. Transition of this mandate is planned for January 2020, and an update is provided later in this report.

Property and Infrastructure Commitments

5. The table below highlights the total commitments to the end of October 2019 being £602million and the amount that has been drawn, i.e. the capital invested being £442million (73%). These types of investments can take several years to be fully committed.

Property & Infrastructure Commitments		Commitment £'m	Amount Drawn Sept 19	%
Total Commitment Property Investments		253	184	73%
Total Commitment Infrastructure Investments		349	258	73%
Total		**602**	**442**	**73%**

Transition of Corporate Bonds to LGPS Central

Corporate Bonds

Transition of assets to LGPS Central

6. LGPS Central have again appointed Inalytics to provide transition oversight to look to provide as smooth a transition as possible within the target implementation shortfall. LGPS Central then asked Inalytics to procure a transition manager and on 22 August appointed Blackrock as Transition Manager. A transition kick off meeting was undertaken again on the 18 November 2019 and funds are likely to transfer early 2020. The Investment Sub Committee and Pension Committee will be kept informed as to progress.

Overall Management Fees

7. The Management fees are in the region of 8.3bps compared to the 17bps we pay now, so an estimated saving based on the existing Assets under management of approximately £0.1m per annum. However, the transitions costs will need to be considered before any real ongoing savings are achieved.

Estimated Funding Levels

8. Table 2 shows the overall Funding level of the Fund. It should be noted that this is a weighted average across all the employers that are part of the Fund The range of funding levels across the employers was circa 20% to 120% (based on 2016 valuation)

9. 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. The Actuary provided a preliminary valuation in September 2019 and further detail is provided in the 2019 Actuarial Valuation Funding Strategy Statement report on this agenda. This has been updated for discount rate assumptions, life expectancy trends, covenant, data quality etc. The estimated funding levels in March 2019 were to 91% with a deficit of £265m. The Asset valuation as at the end of October 2019 was £2.865m.

Table 2: Estimated Pension Fund Funding levels based on a like for like comparison to the 2016 actuarial valuation.

	Mar-16	Mar-18	Oct-18	Dec-18	Mar-19
Assets £'M	1,952	2,701	2,708	2,650	2,795
Liabilities £'M	2,606	2,794	2,861	2,871	3,065*
Surplus (-) / Deficit	**654**	**93**	**153**	**221**	**265**
Estimated Funding Level	**75%**	**97%**	**95%**	**92%**	**91%**

** Note this is based on the Actuary preliminary valuation that the next triennial review is based on. The other Liability figures before this were based on a like for like comparison to the assumptions used in the 2016 valuation.*

10. Note the valuation takes on board the extension of the Equity protection.

Equity Protection update

11. Members will recall that a number of Equity Protection options / considerations were discussed and provided at the last Committee. A caveat to the discussions was that the Actuary believed that the Fund could benefit from using an equity protection strategy in terms of providing increased certainty and affordability of contributions if markets were to deteriorate. Note this only covers our passive portfolio of approximately £1.1bn (including the Equity Protection valuation).

12. A recap of the aspects considered were:

a) **The Governance angle** to protect from the risk of increased employer contributions. This would mean extending the current static strategy to around mid-2020 slightly past the formal sign off date for the 2019 actuarial valuation (31 March 2020). As part of this consideration it would be investigated as to whether more upside participation can be implemented over this period without giving up too much downside protection. This would also provide the Actuary certainty that the Equity Protection is in place when the actuary's rates and adjustments certificate have to be signed off;

b) **The Risk profile** as technically the Equity Protection strategy does help provide diversification in the portfolio and reduces the risk profile as part of the valuation (admittedly at a cost like paying an insurance premium); and

c) **A longer term dynamic strategy.** This needs to be considered as part of the Asset Allocation review that will be conducted from June through to around November 2019 to ascertain whether the Equity Protection Strategy should become an integral part of the Funds future investment strategy.

13. It was agreed that:

a) The Equity Protection current static strategy be extended to mid-2020 to protect employer contributions and provide certainty to the Actuary that the Equity Protection is in place when the actuary certificate must be signed off.

Progress – This has been completed and included in the 2019 valuation

b) Those options be explored as to whether more upside participation can be implemented over this period without giving up too much downside protection be delegated to the Chief Financial Officer in consultation with the Chair of Pensions Committee; and.

Progress – This has been actioned and a summary is provided in the table below

Revised Equity Protection levels implemented

Mandate & Market	Initial Market Level	87% when protection kicks in	70% when protection ends	Level at which cap is achieved	% Level at which cap is achieved	Dividend yield	Total Return including Dividend yield
EDOS 5 - S&P	2,895.90	2,519.40	2,027.10	3,162.60	9.21%	1.54%	10.75%
EDOS 6 - ESTOXX	3,282.80	2,856.00	2,297.90	3,453.50	5.20%	3.24%	8.44%
EDOS 7 - FTSE	7,270.90	6,325.70	5,089.60	7,612.50	4.70%	4.07%	8.77%
EDOS 8 - FTSE	7,157.30	6,226.90	5,010.10	7,530.60	5.21%	4.13%	9.34%

Notes an example: Should the S&P go above the 3,162.6-market value cap then WPF will not benefit from total returns above this level being 10.75%. Likewise, the S&P market value is protected from market falls between the market value of 2519.4 (87%) and 2,027.13 (70%)

c) The Equity Protection Strategy be considered as part of the Asset Allocation review that will be conducted from June through to around November 2019 to ascertain as to whether this should become an integral part of the Funds future investment strategy

Progress – The outcome is included in the Strategic Asset Allocation Report on this agenda.

Strategic Asset Allocation

14. 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 80.0% (81.2% as at June 2019) (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 30th September 2019			**Strategic Asset Allocation targets**	
Asset Class	Portfolio Weight		Asset Class	Portfolio Weight
Actively Managed Equities	**25.9%**		**Actively Managed Equities**	**20.0%**
Far East Developed	14.4%		Far East Developed	10.0%
Emerging Markets	11.5%		Emerging Markets	10.0%
Passively Managed Equities – Market Capitalisation Indices	**30.7%**		**Passively Managed Equities – Market Capitalisation Indices**	**40.0%**
United Kingdom	12.7%		United Kingdom	23.5%
North America	11.5%		North America	9.0%
Europe ex UK	6.5%		Europe ex UK	7.5%
Passively Managed Equities – Alternative Indices	**15.5%**		**Passively Managed Equities – Alternative Indices**	**15.0%**
Global	15.5%		Global	15.0%
Equity Protection	**7.8%**			
Fixed Interest	**5.8%**		**Fixed Interest**	**10.0%**
Actively Managed Bonds & Corporate Private Debt	5.8%		Actively Managed Bonds & Corporate Private Debt	10.0%
Actively managed Alternative Assets	**14.3%**		**Actively managed Alternative Assets**	**15.0%**
Property	6.0%		Property & Infrastructure	15.0%
Infrastructure	8.3%			
TOTAL	**100.0%**		**TOTAL**	**100%**

Responsible Investment (RI) Activities

15. 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

16. 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.

Local Authority Pension Fund Forum (LAPFF)

17. 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.

18. Some key highlights from their quarterly engagement report (July to September 19) were:

- Over the summer, LAPFF has been engaging with several defence companies cited for their role in supplying weapons to the Saudi coalition for the war in Yemen. The LAPFF Executive approved this engagement because LAPFF funds have been targeted by protestors concerned about the role of local authorities in funding this war.

- Along with Sarasin, Church Commissioners and Royal London Asset Management, LAPFF has been engaging with Glencore over concerns about corruption in the Democratic Republic of Congo. The issues raised during this engagement prompted the Forum to send engagement requests to four other companies embroiled in corruption probes – Shell, ENI, Petrobras and Total.

- LAPFF issued two voting alerts during the period under review. The first alert related to Sports Direct, a company that has recently faced the ire of investors after its latest results highlighted underwhelming performance as well as substantial unpaid taxes. These issues led to the company's primary auditor, Grant Thornton, announcing the intention to resign ahead of the company AGM.

- The second alert relates to Ryanair. LAPFF has requested that the company improve its governance practices for several years. Despite signing recognition agreements with several unions, Ryanair management still appears to struggle to work constructively with unions and staff to negotiate mutually beneficial terms and conditions of employment

- As part of a wider investor discourse, LAPFF joined a call with Southern Company to discuss the implementation of compensation mechanism which links executive remuneration with climate factors. Southern Company is the second largest gas and electric utility company in the US and has recently set GHG reduction targets of 50% by 2030 (compared 2007 output) and 'low-to-no carbon emissions' by 2050. In support of this target, the company has also announced a new compensation metric that is tied to the carbon reduction goal.

19. Through LAPFF, the Fund engaged with 108 companies during the quarter on issues ranging from human rights climate change, environmental issues, governance and board composition. Most engagements concerned climate change. Two engagements led to a substantial improvement and five engagements led to a change in process /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 4 and is also available on LAPFF's website together with the previous quarterly engagement reports. : LAPFF quarterly-engagement-reports

Stewardship Code

20. In the October report to Committee it was noted that the Financial Reporting Council (FRC) were due to publish a revision to the Stewardship Code. This was published on the 24 October announcing a substantial and ambitious revision to the **UK Stewardship Code**.

21. The new Code substantially raises expectations for how money is invested on behalf of UK savers and pensioners. The new Code establishes a clear benchmark for stewardship as the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society. Key changes include: -

- An extended focus that includes asset owners, such as pension funds and insurance companies, and service providers as well as asset managers. This will help align the approach of the whole investment community in the interest of end-investors and beneficiaries.
- A requirement to report annually on stewardship activity and its outcomes. Signatories' reports will show what has been done in the previous year, and what the outcome was, including their engagement with the assets they invest in, their voting records and how they have protected and enhanced the value of their investments. This greater transparency will allow clients to see how their interests are being served.
- Signatories will be expected to take environmental, social and governance factors, including climate change, into account and to ensure their investment decisions are aligned with the needs of their clients.
- Signatories are now expected to explain how they have exercised stewardship across asset classes beyond listed equity, such as fixed income, private equity and infrastructure, and in investments outside the UK.
- Signatories are required to explain their organisation's purpose, investment beliefs, strategy and culture and how these enable them to practice stewardship. They are also expected to show how they are demonstrating this commitment through appropriate governance, resourcing and staff incentives.

22. The new Code takes effect from the 1 January 2020 and it is understood as we are an existing signatory to the existing code we will have approximately 12 months to comply. We will be working alongside LGPS Central who are providing support to all the pooling partner funds to help them update their respective Stewardship Code statements.

23. We will report back on the implications as soon as this is known.

Stewardship in Investment Pooling

24. 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 for which the quarter ending the 30 September 2019 is currently available.

Stewardship Themes

25. Each of the partner funds were invited to take part in a short survey, to gauge interest in a list of potential stewardship themes. The outcome was an agreed shortlist of four (proposed at a recent Responsible Investment Working Group RIWG), which comprised of climate change, single-use plastic, technology & disruptive industries, and tax transparency. Further details of these 4 themes and the progress to date is provided in the quarterly stewardship report.

Voting Decisions

26. At the last meeting it was agreed that it would be beneficial for LGPS Central would compile and vote the shares for Worcestershire Pension Fund voting records (via LGPS Central contract with Hermes EOS and executed in line with LGPS Central's Voting Principles).

27. 'Donut' charts for how votes have been cast in different markets and regions (Appendices 5 and 6) and a Table of vote-by-vote disclosure for full transparency is available at Appendix 7.

Development of a Climate Risk Monitoring Platform

28. As highlighted in the June report, the partner fund Responsible Investment Working Group and LGPS Central are developing a Climate Risk Monitoring Service. This would provide four optional deliverables

- Assistance drawing up a climate change framework and strategy
- Per fund an annual climate change risk report tailored to individual funds requirements comprising
    - Climate scenario analysis, fund wide, all asset classes
    - Carbon metrics scorecard (carbon footprint, stranded asset analysis, etc.
    - Annual climate stewardship plan
- Per fund annual training of Pensions Committee
- Task Force for Climate-related Financial Disclosures (TCFD) report for public disclosure with our annual report

29. All partner funds have now agreed to take this forward. A procurement exercise has been completed for Climate Scenario Analysis and Carbon Risk Metrics and providers appointed. Work is now ongoing to look to provide initial reports for each individual partner fund before financial year end.

Contact Points

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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)
- LAPFF Quarterly Engagement Report April to June 2019 (Appendix 4)
- 'Donut' charts for how votes have been cast in different markets and regions Appendices 5 and 6 and a Table of vote-by-vote disclosure (Appendix 7)

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 16 October 2019

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REPORT PREPARED FOR

Worcestershire Pension Fund

November 2019

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Independent Investment Adviser's report for the Pension Committee meeting

13 December 2019

Global overview

The Federal Reserve set the tone for the global economy over Q3 in its much-anticipated move of lowering rates. The Fed cut rates in July and September, lowering the target range to 1.75% - 2%. In Europe, the ECB also took measures to stimulate the economy by also cutting rates and re-starting its programme of quantitative easing. Meanwhile, global markets made slight gains, whereas emerging markets fared poorly as many were hit by the knock-on effects of the Fed's rate cut and continued US-China trade tensions. In the UK, Boris Johnson became Prime Minister and Brexit uncertainty continued.

GDP: US GDP is expected to grow 1.9% in Q3, as last quarter's GDP was revised up from 1.8% to 2.0%. This came as the consumer confidence index fell in August from 134.2 to 125.1, and as US-China trade tensions continued to cause concern.

In the UK, Q3 GDP growth is expected to be at 0.3%, despite the continued political uncertainty in the country. The slight reversal to positive this quarter was largely due to the services sector (which makes up approximately 80% of the UK economy), in particular film and television production. In the Eurozone, GDP growth is predicted to be 0.2% for Q3, as the ECB restarted quantitative easing in September amidst weakening growth in the region.

CPI: In Q3, inflation levels in the US stayed consistent with the end of the previous quarter, rising from 1.6% to 1.7%. The indices for housing, and food costs increased but were counterbalanced by falls in energy, used cars and trucks.

In the UK, the consumer price index fell from 2.0% at the end of Q2 to 1.7%; this is below the 2.0% target set by the Bank of England. This decline was driven by motor fuels, electricity, gas and other fuels, and second-hand cars. These moves were partly offset by increases in the costs of furniture, household appliances, hotel stays, recreation, and cultural items.

Central Banks: In Q3, central banks turned towards more dovish policies, with the Federal Reserve cutting rates twice, totalling a 50bp cut. At the same time, the ECB cut rates, for the first time since 2016, by 10 bps, further into negative territory to a record low of -0.5%, as well as restarting its quantitative easing programme. This will make it harder for the incoming ECB president Lagarde to further loosen monetary policies. Across the world, 43 central banks have cut interest rates a total of 67 times in Q3, compared to 26 cuts in Q2, and 19 in Q1. The Bank of England has held firm on interest rates as Brexit uncertainty continued to prevail.

Political Headlines: In the UK, Boris Johnson started his new role as Prime Minister, amidst claims that he would avoid at all costs requesting an extension to Brexit from the European Union. In the US, the main headline was the Federal Reserve cutting interest rates first in July then again in September. In Japan, Abe was re-elected as Prime Minister, while in Italy there was a split in the governing coalition between the Five Star and the Democratic Party.

Summary and Market Background

The value of the Fund in the quarter rose to £2.93bn, an increase of £64m compared to the end June value of £2.87bn. The Fund produced a return of 2.3% over the quarter, which was in line with the benchmark. The equity protection strategy provided a small positive contribution to returns, with the main positives being good performance from the alternative benchmark passive portfolio and from the Nomura Far East mandate. Over a 12-month period the Fund recorded a negative relative return against the benchmark of -0.6% (5.7% v. 6.3%). The Fund has performed close to benchmark over the three, five and ten-year periods, details of which can be found in Portfolio Evaluation Limited's report.

The equity protection strategy mandate with River & Mercantile was originally *implemented to secure some protection to the funding level* against a relatively significant fall in equity values, as seen in the fourth quarter 2018, up until after the next Triennial valuation in April 2019 (covering an 18-month period). This protection has now been extended until Q3 2020 to help manage the Fund's risk profile ahead of the new funding period. Work on the strategic asset allocation review is now well advanced, which will be considered at the Pensions Committee meeting in December. This will include a review of the risks associated with the Fund's relatively high allocation to equities and how that can be mitigated in the future, alongside consideration of a further switch to other asset classes that will seek to maintain returns while reducing risk. The Hymans report has highlighted some asset classes that could be considered in the future, but which are currently unattractive due to their high relative valuations.

Emerging Markets assets have now been transitioned to LGPS Central and their appointed managers (BMO, Vontobel and UBS) and we have their first quarterly report. The transition of the Corporate Bonds mandate, currently managed by JP Morgan, to the LGPS Central sub fund (the appointed managers are Fidelity and Neuberger Berman) has been postponed until early 2020. This is due to the potential for higher than normal market volatility during the period leading up to the UK General Election and possibly afterwards.

Following the transition of the two Emerging Markets mandates to LGPS Central, the Fund effectively now has only two active equity managers. Nomura (Pacific) enjoyed a good quarter, with an outperformance of 1.8%. LGPS Central (Emerging Markets) just about managed an in-line performance during their inaugural quarter. JP Morgan (Bonds) had an outperformance of 0.1% against their benchmark.
The alternative passive strategies outperformed the total passive benchmark by 1.5% (4.9% v. 3.4%). Passive market equities outperformed the active equities group by 1.4% (2.7% v. 1.3%), which reflects in aggregate terms the regional market indices that they represent rising more than those in the active section of the Fund.

Equities

Over the course of Q3 2019, equity markets were a mixed picture: developed equity markets experienced broadly modest growth, helped by central bank action, while emerging market economies fared less well delivering a mix of low or negative returns. Moves by the Federal Reserve and the ECB helped to sustain UK and US equities. US company earnings are estimated to be overall in decline based on reports in earnings season.

UK: UK markets were slightly up in Q3 with the FTSE 100 up by 0.9% while the FTSE All-Share rose 1.2%, bringing its year to date returns to 14.3%. Defensive sectors performed well while more economically sensitive sectors such as financials underperformed. Some investors took advantage of sterling weakness and relative value opportunities in UK equities.

EU: The Euro STOXX 50 increased by 3.1% in Q3. Like other developed markets, the EU region made modest but positive gains over the quarter, boosted by the ECB's move to re-start quantitative easing. However, the knock-on effects of the US-China trade tensions, coupled with political uncertainty in the UK, Italy and Spain meant that equity markets' growth was not pronounced.

US: The US stock market made small gains over the quarter. The S&P 500 index ended Q3 up just 1.7%. Sectors including real estate, utilities and consumer staples performed relatively well while energy, materials and healthcare, the latter given the political sensitivities, performed poorly. Value stocks performed well, while Momentum stocks performed poorly.

Japan: While the Japanese equities market had a difficult start to the quarter, it picked up significantly in September. The Nikkei 225 was up 3.0% over Q3; this added to the positive year to date gains of 10.8%. As Abe was re-elected as Prime Minister, this sent a positive message reassuring markets of the continuation of Abe's policies.

China: The MSCI China Index fell by -4.4%. This came as the Chinese government attempted to counter the negative effects of the US-China trade tensions by boosting its economy with tax cuts, interest rate cuts and increases in government spending.

Emerging Markets: The MSCI Emerging Markets index was down -4.2% for Q3. Markets in Argentina fared particularly poorly after surprise primary election results worried investors about the future of their current pro-business government. The effect of the US-China trade war took its toll on emerging economies as well as global growth concerns. Although MSCI Emerging Markets index returns were poor during Q3, the year to date returns are still positive at 6.1% to the end of September.

Fixed Income

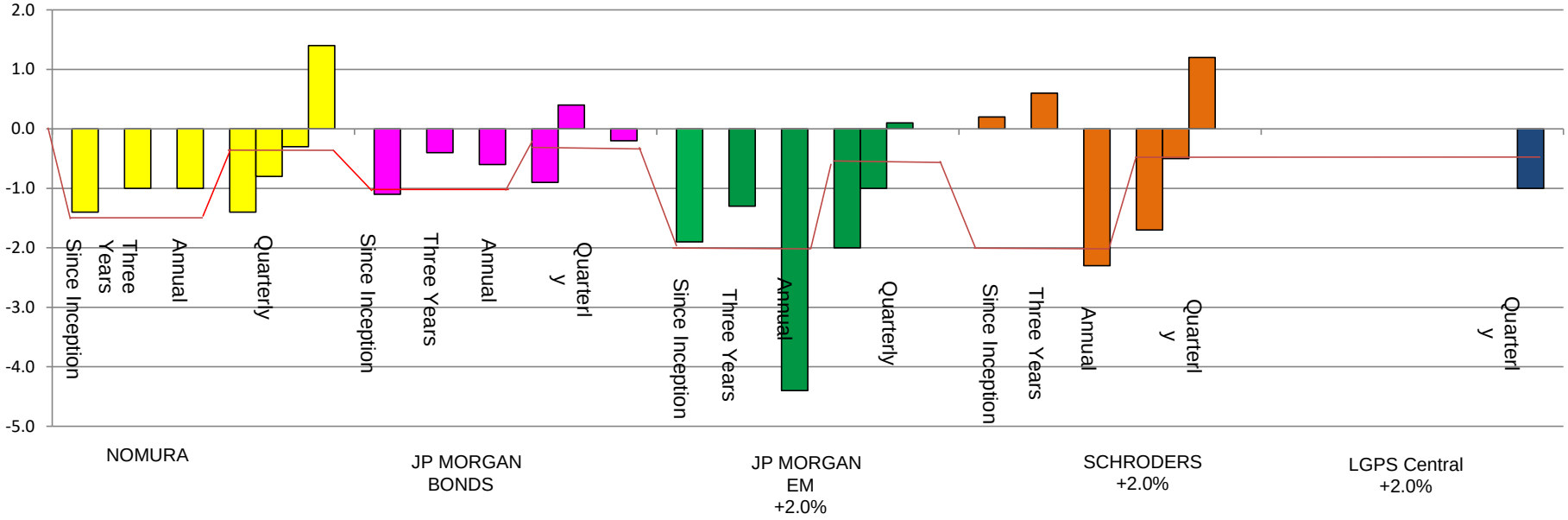
Government Bonds: In Q3, bond yields fell markedly due to global economic, low inflation and trade war concerns. A recovery followed in mid-September as the US and China indicated optimism with the planned resumption of talks in October. The 10-year US Treasury yield fell by 32 bps; the US yield curve temporarily inverted, for the first time since 2007, an indication of a possible slowdown approaching. ECB policy pushed bond yields down throughout the Eurozone with Greek three-month bonds offering negative yields. 10-year German and Japanese government bond yields both fell further into negative territory. In Britain, the UK 10-year yield fell by 34 bps. This was due, once again, to Brexit uncertainty.

Investment Grade Corporate Bonds: In Q3, IG corporate bonds outperformed government and high yield bonds: US investment grade bonds outperformed both US government and US high yield bonds; UK government, investment grade, and high yield bonds outperformed all of these. The Bloomberg Barclays US Corporate Investment Grade TR Index Unhedged returned 3.1%, bringing the year to date return up to 13.2%. The telecoms and utility sectors had strong performance. Whilst US corporate bond option-adjusted spreads were broadly unchanged, looser monetary policy from the Federal Reserve and the ECB have supported investor confidence in the commitment of central banks to the economy.

High Yield Credit: Whilst geopolitical uncertainty continues across the globe, high yield credit generally performed well during the third quarter. The Bloomberg Barclays US Corporate High Yield TR Index Unhedged returned 1.3% over Q3. US high yield spreads continue to be tighter than the historical average, tightening 5bp over Treasuries. Concerns over the possibility of defaults increasing due to the stage of the credit cycle remained, although corporate earnings seem to be resilient overall and the HY default rate remained low by historical standards.

Worcestershire County Council Pension Fund - Chart showing for each active manager: performance since inception, three years, annual performance October 2018 to September 2019 and latest year in quarter ends October 2018 to September 2019, relative to performance requirement

0 = Performance Requirement (**PR**),
Red line = Bench Mark



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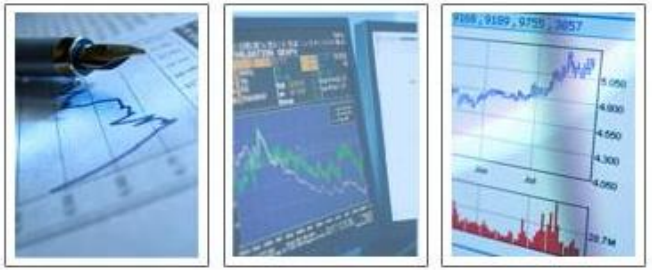
PORTFOLIO EVALUATION LIMITED

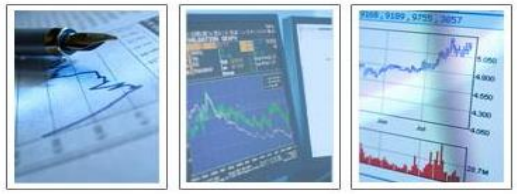


Specialists in Investment Risk and Return Evaluation

Quarterly Risk and Return Analysis
Total Fund

Worcestershire County Council Pension Fund

Period ending 30th September 2019



Specialists in Investment Risk and Return Evaluation

PORTFOLIO EVALUATION LIMITED

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- Manager Performance Summary 08
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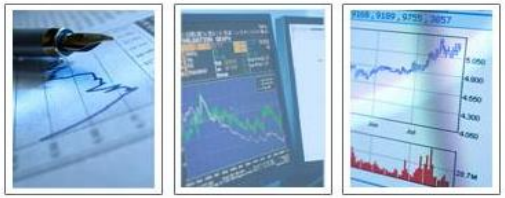
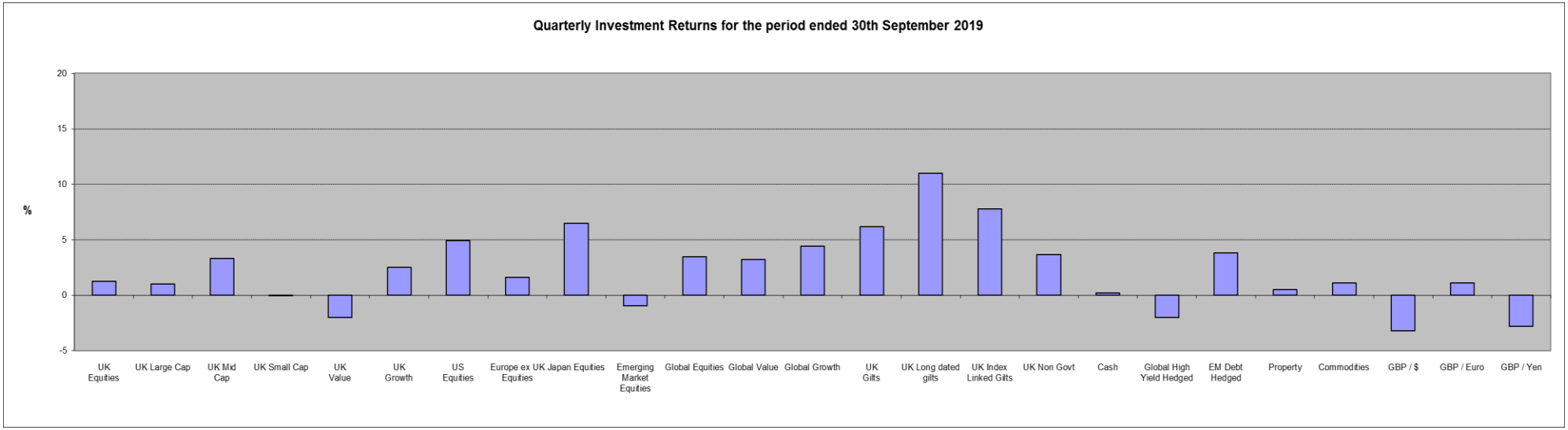


Specialists in Investment Risk and Return Evaluation

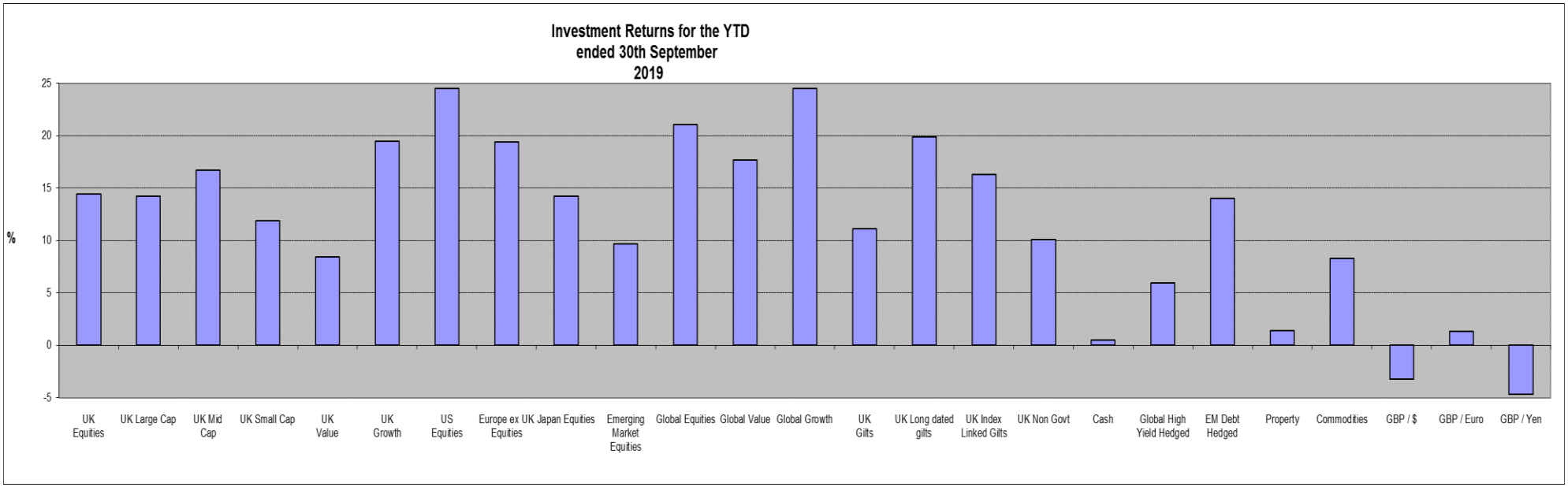
Portfolio Evaluation Ltd Market Commentary Q3 2019 (Sterling)

After a positive first quarter and year most markets continued with positive returns, albeit at a more subdued level, in the quarter ended September 2019. The markets continue upwards, even after a small correction in August that was followed by a recovery in September despite lower economic growth and lower corporate earnings growth. Some of this could be due to continued global economic growth (albeit slower) supported by dovish central bank policy, continuing low inflation and positive consumer demand (it should be noted that there is in the developed world a lower supply of available workers); however the markets appear to be going from panic mode to complacency when reviewing risk. The positive global outlook this quarter saw growth stocks continue to outperform value but the difference between the two was less than in periods last year.

It would appear that markets are set to remain in a late market cycle phase for a while given the economic growth and it is not uncommon for markets to produce positive returns in this phase; however this can be more volatile. Looking forwards market commentators continue to expect lower global economic growth and corporate earnings growth with the Eurozone looking particularly vulnerable. Many investors seem to expect growth to continue into 2020 and potentially to 2021 as the outlook for a recession gets moved back due partly positive central bank actions and benign inflation. However many market commentators are discussing more defensive strategies going forwards, and many are also viewing emerging markets positively. Commentators are also investing more in bonds to secure income and as a defensive move. There are some risks in the returns that can be achieved , these include Trade Wars remain on going between the US, China and to some degree Europe, we are also in the position where central banks may not be able to continue lowering interest rates much more. We are also seeing increased political risk.



Within the UK the obsession and lack of resolution with Brexit has continued through yet another quarter. This continues to lower the economic growth outlook and reduce the willingness of both companies and investment managers to invest in the UK. The 'high street' sector continues to struggle with high costs and lower revenues whilst business is still reviewing how to proceed in the future. Despite posting significant equity market gains the concerns about the future outlook helps to explain the relatively lack lustre performance of UK stockmarkets when compared to many others.



Market volatility has continued to increase as a result of the outlook and in particular the risk levels between asset classes has also increased as diversification benefits reduce. Many commentators expect this to continue throughout the remainder of this year.

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.

Worcestershire County Council Pension Fund - Commentary
Period ending 30th September 2019

QUARTERLY SUMMARY: **Worcestershire County Council Pension Fund Return: 2.3% Benchmark Return: 2.3% Excess Return: 0.0%**

- The Fund invested approximately 11% of its assets in the new LGPSC Equity Emerging Markets Fund at the beginning of this quarter. This was primarily funded by disinvesting from the Equity Emerging Markets Funds managed by JP Morgan and Schroders. The LGPSC Equity Emerging Markets Fund was transitioning assets from the beginning of July and went live on the 19th July. Please note that for reporting purposes the LGPSC Emerging Markets Fund has been measured from the 19th July whilst the period from 2nd July to the 19th July is shown as a transition portfolio.
- All primary asset classes achieved similar returns (between 1.8% and 2.3%) over the quarter. Within equities the Alternatives section was the highest performer. Over the quarter the Nomura portfolio (Far East Equities), EQT mid-market credit, Walton (property), Hermes II (infrastructure) and First State were the notable outperformers. The primary underperformer was the Equity Emerging Markets portfolio group; however it should be noted that this group was in transition in July. The other significant underperformers were the Invesco property funds, Green Bank (UK Infrastructure) and the bond portfolio underpinning the Equity Protection Overlay (EPO).
- Over the quarter the EPO portfolio had an overall return of 0.1% and improved the overall equity return by 0.2%.
- Over the quarter the Fund outperformed marginally (less than 5 bps) due to the EPO, excluding the EPO the Fund would have underperformed slightly; the same pattern is evident for the equity totals. The Fund had positive excess return from asset allocation due to being overweight equities (higher performing sub asset classes when compared to the Total Fund benchmark). In terms of stock selection attribution the overall contribution to excess return was neutral (i.e. 0) and the only significant positive contributor was the Nomura Far East equity portfolio.
- All index funds tracked their benchmarks as expected.
- The latest valuation data supplied by VENN, Walton Street I, Green, EQT, Invesco Real Estate UK Residential Fund and Stonepeak was for period ending June 2019.

YEAR SUMMARY: **Worcestershire County Council Pension Fund Return: 5.7% Benchmark Return: 6.3% Excess Return: -0.6%**

- Over the year the Fund has generated a return of 5.7% underperforming its benchmark by -0.6%; when excluding the equity options overlay, the Total Fund underperformed by -0.7% (i.e. the EPO strategy has added value). Over the year bonds have been the strongest performer followed by Infrastructure, Property and finally Equities.
- Stock selection was the dominant contributor of the underperformance over the year due primarily to the underperforming Emerging Equity Market portfolios this quarter (this group was in transition mode from mid-June to mid-July).
- Asset allocation was a negative contributor over the year via the overweight exposure to the low returning Active Equity portfolios;
- Overall whilst providing a positive boost to the Equity return of the Fund the EPO, because no benchmark has been assigned and the gilts used as collateral has been a drag on Fund performance, as it has a lower return than other asset groups. However it has provided excess return in the relevant markets and has lowered Fund volatility i.e. it is performing as expected.
- All index funds tracked their benchmarks as expected.

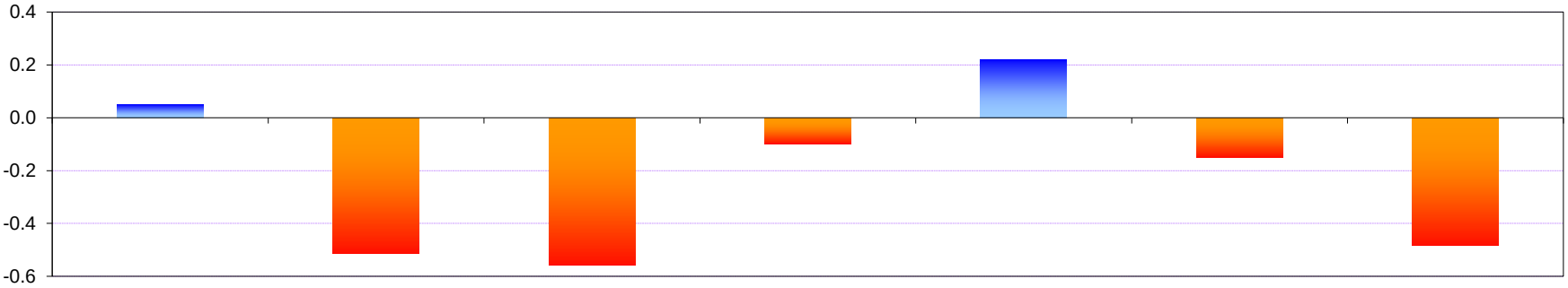
THREE YEAR SUMMARY AND LONGER: **Worcestershire County Council Pension Fund Return: 8.7% Benchmark Return: 8.8% Excess Return: -0.1%**

- Over the three year period, the Fund has generated a return of 8.7% and has underperformed the benchmark by -0.1%. It should be noted that there has been a significant number of new mandates established in that timeline especially in the property and infrastructure asset classes. Additionally an equity protection overlay program (EPO) has been started and recently the EMM equity portfolio has been restructured.
- The EPO has reduced overall performance because equity markets have continued to rise over the last few years; however Fund volatility has reduced. In effect the EPO is performing as expected given its mandate and structure.
- 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: £2.9bn

Total Fund Overview
Worcestershire CC Pension Fund
Report Period: Quarter Ending September 2019

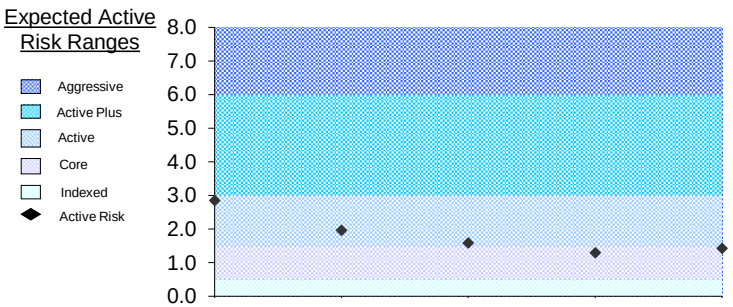
Excess Return Analysis (%)



	QTR	YTD	1 Yr	3 Yr	5 Yr	10Yr	Since Mar 87 (p.a.)
Excess Return	0.0	-0.5	-0.6	-0.1	0.2	-0.1	-0.5
Portfolio Return	2.3	6.4	5.7	8.7	9.8	9.1	8.1
Benchmark Return	2.3	6.9	6.3	8.8	9.5	9.2	8.6

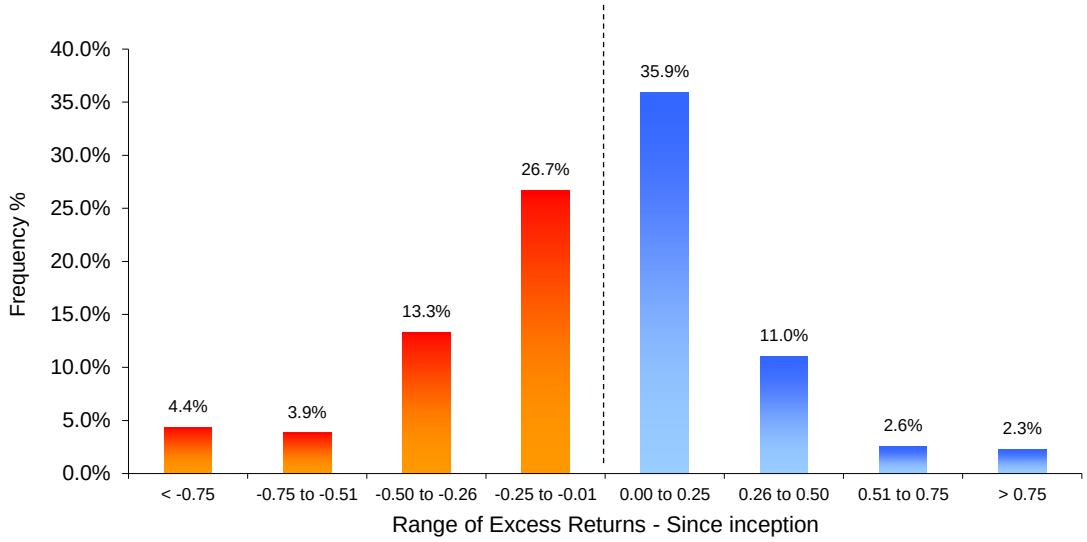
All returns for periods in excess of 1 year are annualised. The portfolio return is net.

Ex-Post Active Risk Analysis (%)



	1 Yr	3 Yr	5 Yr	10 Yr	Mar 87
Active Risk	2.9	2.0	1.6	1.3	1.4
Portfolio Risk	6.9	6.7	7.9	9.7	12.6
Benchmark Risk	9.3	7.5	8.2	9.6	12.4

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, calcula ted using monthly (or quarterly if indicated) returns since inception.

PORTFOLIO EVALUATION LIMITED

Attribution to Total Fund Excess Return Analysis
Worcestershire County Council Pension Fund
for Quarter Ended 30th September 2019

Market Value: £2.9bn

	Total Fund	Total Fund ex Overlay	Total Equity	Total Equity ex Overlay	*Total Active*	Far East Dev - Nomura	EMM - LGPSC	EMM - JPM	EMM - Schroder	*Transition*	*Total Passive*	UK - L&G	North American - L&G	Europe ex UK - L&G	*Total Alts*	FTSE RAFI DEV - L&G	MSCI Wld Min Vol - L&G	MSCI Wld Qual - L&G	*R&M EPO*	*R&M EPO ex Overlay*	Corp Bond - JPM	EQT Mid-Mkt Credit II	Total Property	*Total UK Property*	UK Prop - Invesco	UK Prop - VENN	US Prop - Walton Street	US Prop - Walton Street II	Euro Prop - Invesco	Prop - AEW	Total Infra	UK Infra - Green	UK Infra Core - Hermes	UK Infra - Hermes II	Infra Core - Stonepeak	First State
Returns Summary (%)																																				
Excess Return	**0.0**	**-0.1**	**0.0**	**-0.1**	**-0.1**	1.8	-0.5	-1.6	-1.6	-1.8	**0.4**	0.0	0.0	0.0	**-0.1**	0.0	0.1	0.0	**0.1**	**-1.2**	**0.1**	**5.0**	**-0.7**	-0.6	-1.3	0.4	2.5	0.6	-1.7	-0.2	**0.8**	-2.3	0.2	3.3	-1.4	20.3
Portfolio Return	**2.3**	**2.2**	**2.4**	**2.2**	**1.3**	4.9	-3.7	0.0	0.0	1.0	**2.7**	1.3	4.9	1.5	**4.9**	3.5	6.6	5.0	**0.1**	**-1.2**	**2.4**	**6.6**	**1.1**	1.6	0.9	2.5	4.1	2.3	-0.1	1.4	**2.8**	-0.5	2.3	5.3	1.5	22.4
Benchmark Return	**2.3**	**2.3**	**2.3**	**2.3**	**1.3**	3.1	-3.2	1.6	1.6	2.8	**2.3**	1.3	4.9	1.5	**5.0**	3.5	6.5	5.0	**0.0**	**0.0**	**2.3**	**1.6**	**1.8**	2.2	2.2	2.2	1.6	1.7	1.6	1.6	**2.1**	1.8	2.0	2.1	2.9	2.2
Asset Allocation Summary (%)																																				
Portfolio Start	**100.0**	**100.0**	**81.2**	**81.2**	**27.1**	14.1	0.0	6.0	7.0	0.0	**30.9**	13.2	11.2	6.5	**15.1**	5.8	4.5	4.9	**8.0**	**8.1**	**5.3**	**0.5**	**6.2**	2.3	1.4	0.9	0.6	0.1	2.5	0.7	**6.9**	1.7	1.7	1.0	0.4	2.2
Portfolio End	**100.0**	**99.5**	**80.0**	**79.5**	**25.9**	14.4	11.5	0.0	0.0	0.0	**30.7**	12.7	11.5	6.5	**15.5**	5.8	4.7	5.0	**7.8**	**7.4**	**5.3**	**0.5**	**6.0**	2.3	1.4	0.9	0.6	0.1	2.4	0.7	**8.3**	1.7	1.7	1.4	2.1	1.4
Benchmark Start	**100.0**	**100.0**	**76.9**	**76.9**	**24.0**	12.0	0.0	6.0	6.0	0.0	**42.9**	22.4	11.0	9.5	**10.0**	3.3	3.3	3.3	**0.0**	**0.0**	**9.2**	**0.8**	**6.2**	2.3	1.4	0.9	0.6	0.1	2.5	0.7	**6.9**	1.7	1.7	1.0	0.4	2.2
Benchmark End	**100.0**	**100.0**	**75.7**	**75.7**	**24.0**	12.0	12.0	0.0	0.0	0.0	**41.7**	21.2	11.0	9.5	**10.0**	3.3	3.3	3.3	**0.0**	**0.0**	**9.2**	**0.8**	**6.0**	2.3	1.4	0.9	0.6	0.1	2.4	0.7	**8.3**	1.7	1.7	1.4	1.4	2.1
Attribution to Excess Return (%)																																				
Excess Return	**0.0**	**-0.1**	**0.0**	**-0.1**	**-0.1**	0.3	0.0	-0.2	-0.2	0.0	**0.1**	0.1	0.0	0.0	**0.1**	0.0	0.1	0.0	**-0.2**	**-0.3**	**0.0**	**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
Asset Allocation	**0.1**	**0.1**	**0.1**	**0.1**	**0.0**	0.0	0.0	0.0	0.0	0.0	**0.1**	0.1	0.0	0.0	**0.1**	0.0	0.1	0.0	**-0.2**	**-0.2**	**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	0.0
Stock Selection	**0.0**	**-0.2**	**-0.1**	**0.0**	**-0.1**	0.2	0.0	-0.2	-0.2	0.0	**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	0.0	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	0.0	0.1

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 30th September 2019

Market Value: £2.9bn

	Total Fund	Total Fund ex Overlay	Total Equity	Total Equity ex Overlay	Total Active	Far East Dev - Nomura	EMM - LGPSC	EMM - JPM	EMM - Schroder	Transition	Total Passive	UK - L&G	North American - L&G	Europe ex UK - L&G	Total Alts	FTSE RAFI DEV - L&G	MSCI Wld Min Vol - L&G	MSCI Wld Qual - L&G	R&M EPO	R&M EPO ex Overlay	Corp Bond - JPM	EQT Mid-Mkt Credit II	Total Property	Total UK Property	UK Prop - Invesco	UK Prop - VENN	US Prop - Walton Street	US Prop - Walton Street II	Euro Prop - Invesco	Prop - AEW	Total Infra	UK Infra - Green	UK Infra Core - Hermes	UK Infra - Hermes II	Infra Core - Stonepeak	First State
Returns Summary (%)																																				
Excess Return	**-0.6**	**-0.7**	**-0.3**	**-0.4**	**-1.4**	0.4	-0.5	-3.3	-1.5	-1.8	**0.7**	0.0	0.0	-0.2	**-0.6**	0.0	0.0	-0.1	**4.5**	**1.7**	**0.4**	**1.5**	**-2.5**	-1.7	-11.7	0.0	5.4	0.6	-4.7	-0.7	**-0.7**	1.3	-2.5	-9.3	12.4	18.1
Portfolio Return	**5.7**	**5.5**	**5.5**	**5.4**	**3.0**	2.1	-3.7	6.1	8.0	1.0	**6.1**	2.7	10.4	6.0	**10.5**	5.1	16.3	11.9	**4.5**	**1.7**	**10.1**	**8.0**	**4.6**	7.3	-2.7	9.1	11.9	2.3	1.8	8.1	**8.1**	8.9	5.9	-0.8	24.4	27.1
Benchmark Return	**6.3**	**6.3**	**5.8**	**5.8**	**4.4**	1.6	-3.2	9.4	9.4	2.8	**5.4**	2.7	10.4	6.2	**11.2**	5.2	16.3	12.0	**0.0**	**0.0**	**9.7**	**6.5**	**7.1**	9.0	9.0	9.0	6.5	1.7	6.5	8.7	**8.7**	7.6	8.4	8.5	12.0	9.0
Asset Allocation Summary (%)																																				
Portfolio Start	**100.0**	**100.0**	**85.9**	**85.9**	**28.2**	15.8	0.0	5.8	6.6	0.0	**34.4**	15.0	12.2	7.2	**15.4**	6.1	4.5	4.9	**7.8**	**0.0**	**5.0**	**0.2**	**4.7**	0.0	0.0	1.0	0.5	0.0	2.5	0.7	**4.2**	1.8	1.4	0.2	0.3	0.6
Portfolio End	**100.0**	**99.5**	**80.0**	**79.5**	**25.9**	14.4	11.5	0.0	0.0	0.0	**30.7**	12.7	11.5	6.5	**15.5**	5.8	4.7	5.0	**7.8**	**7.4**	**5.3**	**0.5**	**6.0**	2.3	1.4	0.9	0.6	0.0	2.4	0.7	**8.3**	1.7	1.7	1.4	2.1	1.4
Benchmark Start	**100.0**	**100.0**	**81.0**	**81.0**	**24.0**	12.0	0.0	6.0	6.0	0.0	**47.0**	26.5	11.0	9.5	**10.0**	3.3	3.3	3.3	**0.0**	**0.0**	**9.6**	**0.4**	**4.7**	0.0	0.0	1.0	0.5	0.0	2.5	0.7	**4.2**	1.8	1.4	0.2	0.3	0.6
Benchmark End	**100.0**	**100.0**	**75.7**	**75.7**	**24.0**	12.0	12.0	0.0	0.0	0.0	**41.7**	21.2	11.0	9.5	**10.0**	3.3	3.3	3.3	**0.0**	**0.0**	**9.2**	**0.8**	**6.0**	2.3	1.4	0.9	0.6	0.0	2.4	0.7	**8.3**	1.7	1.7	1.4	1.4	2.1
Attribution to Excess Return (%)																																				
Excess Return	**-0.6**	**-0.7**	**-0.3**	**-0.5**	**-0.6**	-0.1	0.0	-0.3	-0.2	0.0	**0.3**	0.4	0.0	0.0	**0.1**	0.0	0.1	0.1	**-0.2**	**-0.4**	**-0.2**	**0.0**	**-0.1**	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	**0.0**	0.0	0.0	0.0	0.1	-0.1
Asset Allocation	**-0.5**	**-0.4**	**-0.3**	**-0.2**	**-0.1**	-0.2	0.0	0.0	0.0	0.0	**0.3**	0.4	0.0	0.0	**0.1**	0.0	0.1	0.1	**-0.7**	**-0.5**	**-0.2**	**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	0.1	-0.1
Stock Selection	**-0.1**	**-0.4**	**0.1**	**-0.3**	**-0.4**	0.1	0.0	-0.3	-0.2	0.0	**0.0**	0.0	0.0	0.0	**0.0**	0.0	0.0	0.0	**0.5**	**0.2**	**0.0**	**0.0**	**-0.1**	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0

Attribution to Total Fund Excess Return Analysis - Unannualised
Worcestershire County Council Pension Fund
for 3 Year Ended 30th September 2019

Market Value: £2.9bn

	Total Fund	Total Fund ex Overlay	Total Equity	Total Equity ex Overlay	*Total Active*	Far East Dev - Nomura	EMM - LGPSC	EMM - JPM	EMM - Schroder	Transition	*Total Passive*	UK - L&G	North American - L&G	Europe ex UK - L&G	*Total Alts*	FTSE RAFI DEV - L&G	MSCI Wld Min Vol - L&G	MSCI Wld Qual - L&G	*R&M EPO*	*R&M EPO ex Overlay*	Corp Bond - JPM	EQT Mid-Mkt Credit II	Total Property	*Total UK Property*	UK Prop - Invesco	UK Prop - VENN	US Prop - Walton Street	US Prop - Walton Street II	Euro Prop - Invesco	Prop - AEW	Total Infra	UK Infra - Green	UK Infra Core - Hermes	UK Infra - Hermes II	Infra Core - Stonepeak	First State
Returns Summary (%)																																				
Excess Return	**-0.3**	**-0.1**	**-1.5**	**-1.1**	**1.2**	2.0	-0.5	-2.6	5.2	-1.8	**1.7**	0.7	0.2	-0.7	**-1.8**	-0.3	0.1	-0.6	**-0.3**	**-6.5**	**1.7**	**6.2**	**-0.7**	-4.0	-14.1	11.0	5.9	0.6	-5.0	-1.7	**-2.4**	-0.1	-7.4	-15.5	-18.4	20.2
Portfolio Return	**28.3**	**28.5**	**30.1**	**30.5**	**28.5**	28.9	-3.7	27.5	35.2	1.0	**32.9**	22.4	52.7	32.7	**41.4**	36.3	39.2	53.1	**-0.3**	**-6.5**	**11.1**	**14.9**	**22.1**	7.3	-2.7	40.6	26.7	2.3	15.8	11.7	**24.6**	24.5	20.0	-4.0	3.6	32.4
Benchmark Return	**28.6**	**28.6**	**31.6**	**31.6**	**27.3**	26.9	-3.2	30.0	30.0	2.8	**31.2**	21.7	52.5	33.4	**43.2**	36.6	39.1	53.7	**0.0**	**0.0**	**9.4**	**8.7**	**22.8**	11.4	11.4	29.5	20.8	1.7	20.8	13.4	**26.9**	24.6	27.4	11.5	21.9	12.2
Asset Allocation Summary (%)																																				
Portfolio Start	**100.0**	**100.0**	**85.9**	**85.9**	**28.8**	16.0	0.0	6.1	6.6	0.0	**44.7**	27.6	11.3	5.8	**12.4**	3.7	4.5	4.3	**0.0**	**0.0**	**6.2**	**0.0**	**4.5**	0.0	0.0	1.2	0.3	0.0	3.0	0.0	**3.3**	1.6	1.7	0.0	0.0	0.0
Portfolio End	**100.0**	**99.5**	**80.0**	**79.5**	**25.9**	14.4	11.5	0.0	0.0	0.0	**30.7**	12.7	11.5	6.5	**15.5**	5.8	4.7	5.0	**7.8**	**7.4**	**5.3**	**0.5**	**6.0**	2.3	1.4	0.9	0.6	0.0	2.4	0.7	**8.3**	1.7	1.7	1.4	2.1	1.4
Benchmark Start	**100.0**	**100.0**	**82.2**	**82.2**	**24.0**	12.0	0.0	6.0	6.0	0.0	**48.2**	27.7	11.0	9.5	**10.0**	3.3	3.3	3.3	**0.0**	**0.0**	**10.0**	**0.0**	**4.5**	0.0	0.0	1.2	0.3	0.0	3.0	0.0	**3.3**	1.6	1.7	0.0	0.0	0.0
Benchmark End	**100.0**	**100.0**	**75.7**	**75.7**	**24.0**	12.0	12.0	0.0	0.0	0.0	**41.7**	21.2	11.0	9.5	**10.0**	3.3	3.3	3.3	**0.0**	**0.0**	**9.2**	**0.8**	**6.0**	2.3	1.4	0.9	0.6	0.0	2.4	0.7	**8.3**	1.7	1.7	1.4	1.4	2.1
Attribution to Excess Return (%)																																				
Excess Return	**-0.3**	**-0.1**	**-1.1**	**-0.9**	**0.1**	0.2	0.0	-0.3	0.2	0.0	**0.1**	0.4	0.0	-0.3	**0.4**	0.1	0.1	0.2	**-1.8**	**-1.5**	**0.9**	**0.0**	**0.0**	0.1	0.0	0.1	0.0	0.0	-0.1	0.0	**-0.1**	0.0	-0.1	0.0	0.1	-0.1
Asset Allocation	**-0.4**	**0.2**	**-1.2**	**-0.6**	**-0.2**	-0.1	0.0	-0.1	0.0	0.0	**-0.1**	0.2	0.0	-0.3	**0.5**	0.1	0.1	0.3	**-1.4**	**-0.8**	**0.8**	**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	0.1	-0.1
Stock Selection	**0.1**	**-0.3**	**0.1**	**-0.3**	**0.3**	0.3	0.0	-0.2	0.2	0.0	**0.2**	0.2	0.0	0.0	**0.0**	0.0	0.0	0.0	**-0.4**	**-0.7**	**0.1**	**0.0**	**0.0**	0.1	0.0	0.1	0.0	0.0	-0.1	0.0	**-0.1**	0.0	-0.1	0.0	0.0	0.0

Manager Return Analysis
Worcestershire County Council Pension Fund
for Period Ended 30th September 2019

Market Value: £2.9bn

	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**	**2,345.6**	**80.0**	**2.4**	**2.3**	**0.0**	**6.7**	**7.5**	**-0.8**	**5.5**	**5.8**	**-0.3**	**9.2**	**9.6**	**-0.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**13.0**	**13.1**	**-0.1**
Total Equity Fund ex Overlay	**Client Specific Weighted Index**	**Mar-16**	**2,331.3**	**79.5**	**2.2**	**2.3**	**-0.1**	**7.2**	**7.5**	**-0.3**	**5.4**	**5.8**	**-0.4**	**9.3**	**9.6**	**-0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**13.0**	**13.1**	**0.0**
Total Active Equity Fund	Client Specific Weighted Index	Mar-16	759.3	25.9	1.3	1.3	-0.1	5.9	5.3	0.6	3.0	4.4	-1.4	8.7	8.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0	14.2	13.4	0.8
Far East Developed Fund - Nomura	FTSE Developed Asia Pacific Index	Feb-03	423.1	14.4	4.9	3.1	1.8	9.4	7.4	2.0	2.1	1.6	0.4	8.8	8.3	0.6	11.8	11.1	0.8	9.0	8.5	0.5	10.5	10.4	0.1
Emerging Markets Fund - LGPSC	FTSE All World Emerging Market Index	Jul-19	336.2	11.5	-3.7	-3.2	-0.5																-3.7	-3.2	-0.5
Emerging Markets Fund - JPM	FTSE All World Emerging Market Index	Dec-11	0.0	0.0	0.0	1.6	-1.6	4.4	5.5	-1.0	6.1	9.4	-3.3	8.9	9.7	-0.8	9.5	9.5	0.0				7.7	7.8	-0.1
Emerging Markets Fund- Schroder	FTSE All World Emerging Market Index	Oct-11	0.0	0.0	0.0	1.6	-1.6	5.5	5.5	0.0	8.0	9.4	-1.5	11.2	9.7	1.5	11.2	9.5	1.7				9.1	7.2	1.9
Transition Fund	FTSE All World Emerging Market Index	Jul-19	0.0	0.0	1.0	2.8	-1.8																1.0	2.8	-1.8
Total Passive Equity Fund	Client Specific Weighted Index	Mar-16	900.5	30.7	2.7	2.3	0.4	8.5	7.7	0.8	6.1	5.4	0.7	9.9	9.5	0.5							12.9	12.3	0.6
UK Equity Fund - L&G	FTSE All Share Index	Dec-15	373.4	12.7	1.3	1.3	0.0	4.6	4.6	0.0	2.7	2.7	0.0	7.0	6.8	0.2							9.8	9.6	0.2
North American Equity Fund- L&G	FTSE All World North American Index	Dec-15	337.2	11.5	4.9	4.9	0.0	12.1	12.1	0.0	10.4	10.4	0.0	15.2	15.1	0.1							18.7	18.7	0.0
Europe ex UK Equity Fund- L&G	FTSE Developed Europe Ex. UK Index	Dec-15	189.9	6.5	1.5	1.5	0.0	10.3	10.5	-0.2	6.0	6.2	-0.2	9.9	10.1	-0.2							12.4	12.7	-0.2
Total Alternatives Fund	Client Specific Weighted Index	Mar-16	455.7	15.5	4.9	5.0	-0.1	11.5	11.8	-0.2	10.5	11.2	-0.6	12.2	12.7	-0.5							15.3	15.7	-0.4
FTSE RAFI DEV Fund - L&G	FTSE RAFI Developed 1000 QSR Net Index	Dec-15	170.7	5.8	3.5	3.5	0.0	9.4	9.4	0.0	5.1	5.2	0.0	10.9	11.0	-0.1							14.9	15.0	-0.1
MSCI World Min Vol TR Fund - L&G	MSCI World Minimum Volatility Net Index	Dec-15	138.6	4.7	6.6	6.5	0.1	14.0	13.9	0.0	16.3	16.3	0.0	11.7	11.6	0.0							16.9	16.9	0.0
MSCI World Quality TR Fund - L&G	MSCI World Quality Total Return Net Index	Dec-15	146.3	5.0	5.0	5.0	0.0	11.8	11.9	0.0	11.9	12.0	-0.1	15.3	15.4	-0.1							18.3	18.4	-0.1
Equity Protection - River & Mercantile		Jan-18	230.2	7.8	0.1	0.0	0.1	-5.1	0.0	-5.1	4.5	0.0	4.5										-0.1	0.0	-0.1
Equity Protection - River & Mercantile ex Overlay		Jan-18	215.8	7.4	-1.2	0.0	-1.2	-1.0	0.0	-1.0	1.7	0.0	1.7										-3.8	0.0	-3.8
Corporate Bond Fund- JPM	**Barclays Capital Global Aggregate - Ex Treasury, Ex Government Related 100% Hedged to GBP**	**Mar-03**	**154.8**	**5.3**	**2.4**	**2.3**	**0.1**	**6.2**	**5.7**	**0.4**	**10.1**	**9.7**	**0.4**	**3.6**	**3.0**	**0.5**	**4.3**	**3.9**	**0.5**	**5.7**	**5.2**	**0.5**	**5.3**	**5.4**	**-0.1**
EQT Mid-Market Credit II	**Absolute Return + 6.5%**	**May-18**	**13.8**	**0.5**	**6.6**	**1.6**	**5.0**	**5.9**	**3.2**	**2.7**	**8.0**	**6.5**	**1.5**										**10.7**	**6.8**	**4.0**
Total Property Fund	**Client Specific Weighted Index**	**Mar-16**	**176.5**	**6.0**	**1.1**	**1.8**	**-0.7**	**3.6**	**3.6**	**0.0**	**4.6**	**7.1**	**-2.5**	**6.9**	**7.1**	**-0.2**							**8.2**	**7.1**	**1.1**
Total UK Property Fund	Absolute Return +9%	Jul-18	68.2	2.3	1.6	2.2	-0.6	2.6	4.4	-1.8	7.3	9.0	-1.7										7.3	9.0	-1.7
UK Property Fund - Invesco	Absolute Return +9%	Oct-18	40.7	1.4	0.9	2.2	-1.3	-2.7	4.4	-7.1	-2.7	9.0	-11.7										-2.7	9.0	-11.7
UK Property Fund - VENN	Absolute Return +9%	Jul-15	27.5	0.9	2.5	2.2	0.4	3.9	4.4	-0.5	9.1	9.0	0.0	12.0	9.0	3.0							10.5	9.2	1.4
US Property Fund- Walton Street GBP	Absolute Return + 6.5%	Feb-16	16.2	0.6	4.1	1.6	2.5	3.7	3.2	0.5	11.9	6.5	5.4	8.2	6.5	1.7							12.6	6.2	6.4
US Property Fund- Walton Street USD	N/A	Feb-16	N/A	N/A	1.8	0.0	1.8	3.8	0.0	3.8	8.1	0.0	8.1	7.6	0.0	7.6							8.6	0.0	8.6
US Property Fund- Walton Street II GBP	Absolute Return + 7.0%	Jun-19	1.6	0.1	2.3	1.7	0.6																2.3	1.7	0.6
Euro Property Fund- Invesco	Absolute Return + 6.5%	Feb-16	70.5	2.4	-0.1	1.6	-1.7	3.7	3.2	0.5	1.8	6.5	-4.7	5.0	6.5	-1.5							7.6	6.3	1.3
Property Fund- AEW	Absolute Return + 6.5%	Oct-17	19.9	0.7	1.4	1.6	-0.2	3.7	3.2	0.5	5.2	6.5	-1.3										5.7	6.5	-0.8
Total Infrastructure Fund	**Client Specific Weighted Index**	**Mar-16**	**242.1**	**8.3**	**2.8**	**2.1**	**0.8**	**5.1**	**4.3**	**0.8**	**8.1**	**8.7**	**-0.7**	**7.6**	**8.3**	**-0.7**							**7.3**	**8.2**	**-1.0**
UK Infrastructure Fund - Green	Absolute Return +7.6%	Apr-15	49.1	1.7	-0.5	1.8	-2.3	3.3	3.7	-0.5	8.9	7.6	1.3	7.6	7.6	0.0							6.0	7.6	-1.6
UK Infrastructure Core Fund - Hermes	Absolute Return +8.4%	May-15	48.9	1.7	2.3	2.0	0.2	3.7	4.1	-0.4	5.9	8.4	-2.5	6.3	8.4	-2.1							6.9	8.4	-1.5
UK Infrastructure Fund - Hermes II	Absolute Return +8.5%	Jun-18	41.4	1.4	5.3	2.1	3.3	5.5	4.2	1.3	-0.8	8.5	-9.3										-3.1	8.8	-11.8
Infrastructure Core Fund - Stonepeak	Absolute Return +12%	Jan-18	60.7	2.1	1.5	2.9	-1.4	1.9	5.8	-3.9	24.4	12.0	12.4										2.0	12.0	-10.0
First State Fund	Absolute Return +9%	Jun-18	42.1	1.4	22.4	2.2	20.3	25.0	4.4	20.6	27.1	9.0	18.1										24.1	9.3	14.9
Worcestershire CC Total Fund ex Overlay		**Mar-87**	**2,918.4**	**100.0**	**2.2**	**2.3**	**-0.1**	**6.8**	**6.9**	**-0.1**	**5.5**	**6.3**	**-0.7**	**8.7**	**8.8**	**0.0**	**9.8**	**9.5**	**0.3**	**9.1**	**9.2**	**-0.1**	**8.1**	**8.6**	**-0.5**
Worcestershire CC Total Fund		**Mar-87**	**2,932.8**	**100.0**	**2.3**	**2.3**	**0.0**	**6.4**	**6.9**	**-0.5**	**5.7**	**6.3**	**-0.6**	**8.7**	**8.8**	**-0.1**	**9.8**	**9.5**	**0.2**	**9.1**	**9.2**	**-0.1**	**8.1**	**8.6**	**-0.5**

PF = Portfolio Return BM = Benchmark Return ER = Excess Return

Total Fund Benchmark

CLIENT SPECIFIC BM AS AT JUNE 2017:

25.5% FTSE All Share

9.5% FTSE Developed Europe Ex UK

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

11% FTSE All World North America

12% FTSE Developed Asia Pacific

Corp Bonds: 10% Barclays Global Agg Corporate Bond HEDGED into GBP

Infrastructure: Weighted Client Specific Index

Property: Weighted Client Specific Index

Notes:

Q3 2019:
- Disinvested from Schroders Emerging Market Equity Fund as at 1st July 2019
- Disinvested from JP Morgan Emerging Market Equity Fund as at 1st July 2019
- Invested into the LGPSC Emerging Market Fund as at 19th July 2019
- Assets from JP Morgan and Schroders moved to transition Fund COB 1st July, assets then moved to LGPS Central COB 18th July

Therefore the returns for the above are partial period returns

Q2 2019: Invested into the Walton Street US Property Fund II on 28/06/2019 and the inclusion of Equity Protection - River & Mercantile ex Overlay which follows in the Total Equity and Total Fund

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 account 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 30th September 2019

PORTFOLIO EVALUATION LIMITED

Market Value: £2.9bn

	30th Jun 2019		Net	Total	Total	30th Sept 2019	
	Market Val (£000s)	Exposure (%)	Investment (£000s)	Income (£000s)	Gain/Loss (£000s)	Market Val (£000s)	Exposure (%)
Total Equity Fund	**2,328,901**	**81.2**	**-38,333**	**4,940,021**	**55,074**	**2,345,642**	**80.0**
Total Equity Fund ex Overlay	**2,330,555**	**81.2**	**-38,333**	**4,940,021**	**39,080**	**2,331,302**	**79.5**
Total Active Equity Fund	777,324	27.1	-28,333	0	10,286	759,277	25.9
Far East Developed Fund - Nomura	403,065	14.1	0	0	20,042	423,106	14.4
Emerging Markets Fund - LGPSC	0	0.0	349,212	0	-13,041	336,171	11.5
Emerging Markets Fund - JPM	173,103	6.0	-173,103	0	0	0	0.0
Emerging Markets Fund- Schroder	201,156	7.0	-201,156	0	0	0	0.0
Transition	0	0.0	-3,286	0	3,286	0	0.0
Total Passive Equity Fund	887,184	30.9	-10,000	0	23,340	900,523	30.7
UK Equity Fund - L&G	378,827	13.2	-10,000	0	4,557	373,384	12.7
North American Equity Fund- L&G	321,338	11.2	0	0	15,895	337,233	11.5
Europe ex UK Equity Fund- L&G	187,019	6.5	0	0	2,888	189,907	6.5
Total Alternatives Fund	434,448	15.1	0	0	21,222	455,670	15.5
FTSE RAFI DEV Fund - L&G	165,005	5.8	0	0	5,716	170,721	5.8
MSCI World Min Vol TR Fund - L&G	130,062	4.5	0	0	8,568	138,630	4.7
MSCI World Quality TR Fund - L&G	139,381	4.9	0	0	6,938	146,319	5.0
Equity Protection - River & Mercantile	229,945	8.0	0	4,940	226	230,172	**7.8**
Equity Protection - River & Mercantile ex Overlay	231,599	8.1	0	4,940	-15,768	215,831	**7.4**
Corporate Bond Fund- JPM	**151,119**	**5.3**	**0**	**0**	**3,664**	**154,783**	**5.3**
EQT Mid-Market Credit II	**12,928**	**0.5**	**0**	**0**	**849**	**13,777**	**0.5**
Total Property Fund	**177,217**	**6.2**	**-1,861**	**923**	**1,100**	**176,456**	**6.0**
Total UK Property Fund	67,250	2.3	-78	0	1,056	68,228	2.3
UK Property Fund - Invesco	40,134	1.4	220	0	368	40,722	1.4
UK Property Fund - VENN	27,116	0.9	-298	0	688	27,506	0.9
US Property Fund- Walton Street	17,307	0.6	-1,783	0	713	16,238	0.6
US Property Fund- Walton Street II	1,571	0.1	0	0	37	1,608	0.1
Euro Property Fund- Invesco	71,261	2.5	0	667	-731	70,530	2.4
Property Fund- AEW	19,827	0.7	0	255	25	19,853	0.7
Total Infrastructure Fund	**198,619**	**6.9**	**37,847**	**0**	**5,650**	**242,116**	**8.3**
UK Infrastructure Fund - Green	50,198	1.7	-856	0	-244	49,098	1.7
UK Infrastructure Core Fund - Hermes	47,908	1.7	-64	0	1,085	48,929	1.7
UK Infrastructure Fund - Hermes II	27,538	1.0	12,363	0	1,465	41,366	1.4
Infrastructure Core Fund - Stonepeak	10,860	0.4	-2,358	0	52,162	60,664	2.1
First State Fund	62,116	2.2	28,763	0	-48,818	42,060	1.4
Cash Fund	**0**	**0.0**	**2,347**	**0**	**-2,347**	**0**	**0.0**
Worcestershire CC Total Fund ex Overlay	**2,870,438**	**100.1**	**0**	**5,863**	**47,996**	**2,918,434**	**99.5**
Worcestershire CC Total Fund	**2,868,784**	**100.0**	**0**	**5,863**	**63,990**	**2,932,774**	**100.0**

Note: Cashflow into cash reflects sum of portfolio contributions minus net investments. It is assumed that cash for the Fund is held outside of the invested assets and is therefore withdrawn from the Total Fund

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Quarterly Engagement report

July-September 2019

BAE Systems, Boeing, Lockheed Martin, Petrobras, ArcelorMittal, National Grid

Local Authority Pension Fund Forum

Amnesty International campaigners drawing attention to UK-manufactured arms being used to commit war crimes in Yemen.

YEMEN

LAPFF engages with defence contractors over Yemen

LAPFF uses community engagement to link stakeholder input to investor value

Objective: ascertain if defence companies have increased their scope for building leverage in setting or influencing contract terms with national governments in relation to social and environmental factors.

Achieved: the reputational damage facing local authority funds as a result of holding Aerospace and Defence companies has been outlined.

In progress: through dialogue the companies have begun to recognise the populations affected by their products as one of their stakeholder groups.

After four years of deadly civil war, according to the UN, over 18 million Yemenis currently lack access to clean drinking water

Over the summer, LAPFF has been engaging with a number of defence companies cited for their role in supplying weapons to the Saudi coalition for the war in Yemen. The LAPFF Executive approved this engagement because LAPFF funds have been targeted by protestors concerned about the role of local authorities in funding this war.

Initially, the Forum contacted nine companies for engagements – BAE Systems, Boeing, Lockheed Martin, Raytheon, Thales, General Electric, General Dynamics, Textron, and Airbus. LAPFF has managed to hold meetings with three companies, BAE, Boeing and Lockheed, despite expecting little or no response from the companies approached.

A limited response was expected owing to the close relationship between defence companies and national governments. This relationship also meant it was not clear at first how to structure these engagements. If companies are contracting with governments in relation to national security, there seems to be little scope for them to influence the governments' approaches to this issue, and the companies engaged pushed this line hard. However, the pre-meeting research and the company discussions have helped to clarify how companies might push back in these situations.

"It is important for companies to recognise all those affected by the products they make and sell as important stakeholders. Without appropriate recognition, companies are unable to build a complete picture of the market and leave themselves exposed to unexpected changes in market dynamics."

Cllr Doug McMurdo
LAPFF Chair

First, in reviewing company materials, it was evident that although defence companies often espouse the principle of stakeholder engagement, affected communities – such as the Yemeni population being bombed – are not included in the scope of stakeholders considered. This omission likely affects the decision-making about the impact of the products

YEMEN

and services these companies offer. In consideration of this likelihood, LAPFF pushed for companies to consider communities affected by these companies' products and services as stakeholders.

Second, different companies have different ways of contracting. For instance, BAE and Lockheed contract almost exclusively with governments. Boeing, however, has a much more robust commercial component. Consequently, Boeing arguably has more leverage in being able to push governments to comply with international human right standards. For example, in this situation, if a government client were to commission weapons that a company isn't comfortable with, or that are to be used for a purpose that a company isn't comfortable with, it would likely be easier for the company to ramp up its commercial production and refuse the government contract.

Third, a number of defence companies are looking at different defence options. For example, cyber security is an area of interest for defence contractors. This area might be considered non-traditional for defence companies, but there seems to be scope for these companies to develop this type of technology – both on a military and commercial basis – rather than continuing to focus exclusively on traditional weaponry. Some companies, like Lockheed, are also selling these services to government clients such as energy departments, not just the military services. Therefore, by developing client relationships with government departments other than the military, companies might be able to pull back when faced with dubious military contracts.

All of the defence companies reviewed for this engagement had values such as 'respect for life' and 'integrity'. It is hard to see how companies can uphold these values if they are trapped in contracts that, by definition, require them to betray these values. Therefore, LAPFF will continue to apply what it has learned so far in engaging with defence contractors to work with these companies to uphold not only their own values, but LAPFF's policies too. The engagements are not easy or straightforward, but at least now there appear to be ways to move the human rights agenda forward in a way that should produce more sustainable returns for LAPFF members, as well as other investors.

● Boeing has a joint direct attack munition contract and a wideband global satellite communication contract with the US Air Force, an MH-47G Block II Chinook (pictured below) contract with the US Army Special Operations, and an F/A-18 service life modification contract with the US Navy.

● The UK has suspended granting new export licenses for arms that might be used by the Saudi Arabia-led coalition in Yemen while it considers a landmark court ruling that found the government's decision-making processes were unlawful. The outcome of this litigation could have implications for BAE, and specifically the planned export to Saudi Arabia of 48 of its Eurofighter Typhoon jets worth £5 billion (top).

COMPANY ENGAGEMENT

Operation Car Wash or 'Lava Jato' is an ongoing corruption investigation which initially started in 2008 involving Petrobras, politicians and construction companies.

GOVERNANCE RISK

Anti-Corruption Engagements Ramp Up

Objective: Ensure companies have made provisions for the potential liabilities associated with the corruption scandals. Ensure companies have updated internal mechanisms for finding and dealing with corruption across all levels of company operations.
Achieved: clarification gained on the extent of the corruption allegations and a the ultimate financial cost that might be incurred as a result of the litigation and the financial damage.
In Progress: dialogue on companies disclosing the extent to which ongoing corruption investigations are impacting profitability and growth.

Along with Sarasin, Church Commissioners and Royal London Asset Management, LAPFF has been engaging with Glencore over concerns about corruption in the Democratic Republic of Congo. The issues raised during this engagement prompted the Forum to send engagement requests to four other companies embroiled in corruption probes – Shell, ENI, Petrobras and Total.

As with the Yemen engagement, there was doubt about whether the companies would be willing to discuss on-going corruption allegations. Shell wrote back re-stating the content of the company's annual report on the matter and batting back the meeting request. However, both ENI and Petrobras got back almost immediately to offer meetings. Total has also now agreed to a meeting.

To date, the meetings with Petrobras and ENI have taken place. It is interesting to note that Petrobras is still a partly state-owned enterprise, although the Brazilian President, Jair Bolsonaro, has stated he would like the Company to be privatised by 2022. ENI began life as a state-owned company but became public in 1992. Shell and Total are both public companies. Given the role of state parties in corruption cases, these distinctions might be highly relevant and will be explored in the remainder of the engagements.

The Petrobras engagement centred around the Car Wash Investigation, a money laundering scandal that found that executives at Petrobras had accepted bribes in return for awarding contracts to construction firms. This outcome led to Petrobras' writing off US$2,527 million of capitalised costs for overpayment to contractors and suppliers

"Companies leave themselves exposed to significant legal, financial and reputational risks if they fail to implement effective anti-corruption control mechanisms. The scandal at Petrobras outlines well the negative impact corruption scandals can have on shareholder value."

Cllr Rob Chapman - LAPFF Vice Chair

COMPANY ENGAGEMENT

VOTING ALERTS

Sports Direct
LAPFF issued two voting alerts during the period under review. The first alert related to Sports Direct, a company that has recently faced the ire of investors after its latest results highlighted underwhelming performance as well as substantial unpaid taxes. These issues led to the company's primary auditor, Grant Thornton, announcing the intention to resign ahead of the company AGM. It is clear to LAPFF that although the Board has undergone significant change in recent years - improving independent oversight at Board level - the new directors have not held Mr Ashley to account, as evidenced by the company's continued spree of disparate retail aquistions. This acquisition strategy has raised significant concerns amoung investors. As a result, LAPFF recommended that member funds vote to oppose the entire board. Given the continued confusion with Grant Thornton and the controversy around Sports Direct's Belgian tax payments, LAPFF also recommended opposing the report and accounts, which are unlikely to give an accurate view of the business.

Ryanair
The second alert relates to Ryanair. LAPFF has requested that the company improve its governance practices for a number of years. Despite signing recognition agreements with a number of unions, Ryanair management still appears to struggle to work constructively with unions and staff to negotiate mutually beneficial terms and conditions of employment. With a board lacking in independence, LAPFF considers the board should be refreshed with a greater proportion of independent directors and skill sets appropriate to address and challenge the current company positions. On this basis, LAPFF recommended that members vote to oppose all board directors who are not independent.

ENGAGEMENT MEETINGS

Remuneration

As part of a wider investor discourse, LAPFF joined a call with Southern Company to discuss the implementation of compensation mechanism which links executive remuneration with climate factors. Southern Company is the second largest gas and electric utility company in the US and has recently set GHG reduction targets of 50% by 2030 (compared 2007 output) and 'low-to-no carbon emissions' by 2050. In support of this target, the company has also announced a new compensation metric that is tied to the carbon reduction goal.

The metric has both quantitative and qualitative components, ranging from adding zero-carbon megawatts and retiring coal to leadership in energy policy and R&D investment. The linking of GHG emissions to executive compensation is becoming more frequent across the energy sector, with Shell announcing similar metrics at the end of 2018.

Whilst the move has been welcomed by stakeholders, a number of concerns relating to Southern's remuneration mechanism were voiced at the meeting. These concerns raised three concerns about whether or not the proposed metrics can be considered effective in incentivising performance: (1) Southern has already announced GHG reductions of over 4,000 MW compared to the maximum award goal of 3,500 MW; (2) a net reduction in GHGs is not conditional upon achieving full vesting of the award as failure to reduce emission output can be offset by the generation of zero-carbon energy; and (3) the GHG reduction element of the award represents just 10% of the CEO's total opportunity under the long-term incentive.

LAPFF also asked the company if they would consider tying the GHG metric to the pay of other executive officers.

COMPANY ENGAGEMENT

AGM ATTENDANCE
THE CLIMATE CRISIS: CLEAN ENERGY AND STRATEGIC RESILIENCE

National Grid

National Grid will be critical player in delivering the infrastructure needed to decarbonise the UK economy and meet government targets. LAPFF has therefore been engaging the company for a number of years to ensure it is managing the risks of a rapid transition. At this year's AGM, Cllr Glyn Carron welcomed the company's recent progress including its analysis on how net zero carbon emissions could potentially be achieved by 2050 and what this would mean for energy demand and use. Cllr Caron also congratulated the company for joining the Powering Past Coal Alliance, which had been a request at the last meeting with the company. Cllr Carron asked whether National Grid were confident they would be able to meet the new demands on the energy system and infrastructure if there was a rapid shift towards decarbonisation, not least regarding electrification of cars and heating of homes. The company outlined some of the challenges of moving away from certain types of fuel and initiatives they were undertaking with government on electric charging points.

"This initiative makes clear that mobilizing for the planet goes hand-in-hand with protecting our pensions, and we need these commitments now."

Scott F Stringer, New York City Comptroller

PROGRESS

- National Grid is planning to implement carbon pricing on all major investment decisions by 2020.
- LAPFF joins an international grouping of investors sending a Statement to over 30 global oil and gas companies, on methane management, disclosure, and the importance of strong U.S. federal methane regulation.
- Earlier this year LAPFF joined other Climate Majority Project coalition members calling on the 20 largest carbon emitting US utility companies to commit to achieving net-zero carbon emissions by 2050, and to make this commitment by September 2020. In late September both DTE Energy and NRG Energy made unambiguous commitments to net-zero carbon emissions by 2050.
- LAPFF also signed up to an investor statement on deforestation and forest fires in the Amazon. The statement called on companies to disclose and implement a commodity-specific no deforestation policy with quantifiable, time-bound commitments covering the entire supply chain. This statement, which was co-ordinated by the PRI, was issued in direct response to the escalating crisis of deforestation and forest fires in in Brazil and Bolivia during the period under review.

The largest steel-maker in the world, ArcelorMittal

LAPFF met with senior executives of ArcelorMittal in early July, following the publication of the company's first Climate Action report.

- **The commitment:** ArcelorMittal has committed to carbon neutrality in Europe by 2050 and to substantial reductions globally.
- **How the company plans to achieve it:** the Climate Action report has quite detailed low emission technology pathways, with the commercial time horizon for each set out.
- **Target setting:** the meeting had a strong focus on target setting, which ArcelorMittal aim to do in 2020, when the methodology for science-based targets for the steel industry is released. The current target is for an 8% carbon footprint reduction by 2020, against a 2007 baseline.
- **Limitations:** Lakshmi Mittal, ArcelorMittal's joint chair, chief executive has been very clear on his view for the need for a green border tax to make implementation of many of the low carbon technologies commercially viable.
- **Focus for future engagement:** as with other Climate Action 100+ engagements, trade association memberships and target setting are key themes. Company participation in the Energy Transitions Commission, which had been a request at the AGM, has emphasised the view of the need to move to hydrogen technology using renewable energy. ArcelorMittal has already launched a new project in Hamburg to use hydrogen on an industrial scale for the direct reduction of iron ore in the steel production process.

SSAB – Swedish steel-making technology with virtually no carbon footprint

A joint investor call/webinar with the Swedish steelmaker, SSAB, provided useful context for understanding how companies are approaching the technological challenges of moving to low or net-zero carbon steel-making.

SSAB are working in partnership with a mining company (LKAB) and a utility (Vattenfall) on the Hybrit project. The Hybrit project is a hydrogen based process, with a byproduct of water instead of carbon dioxide. The partnership appears

COMPANY ENGAGEMENT

a crucial underpin to its success.

There has been much interest in Hybrit from other steel companies, and almost all major steel companies in Europe have launched similar initiatives. Currently, there is a projected 20-30% increase in cost for this steel, but with renewable electricity costs dropping over time, and the EU emissions trading scheme costs for carbon emissions rising, SSAB has concluded that in future, steel from this process will be able to compete in the market with traditionally made steel. In the interim, SSAB considers customers will be willing to pay a premium for low to zero carbon steel. Ultimately, SSAB is aiming for carbon-neutral production by 2045 in line with the national target for Sweden.

Centrica plans to exit oil and gas exploration and production

Following on from a meeting with Centrica's new Chair, Charles Berry, in May, LAPFF participated in an investor meeting/webinar with Centrica executives which provided the opportunity to not only hear about changes to the company's strategy, but also to probe further into the context for Centrica's target setting.

Centrica plans to exit oil and gas production, including selling its stake in Cuadrilla which operates fracking operations in Lancashire. This move supports a strategic focus on customers, which is mirrored by its target setting for carbon reduction. Customer emissions represent 90% of total company emissions, and the target is to reduce the use of gas and electricity by customers by 25% by 2030, with a goal of net zero by 2050.

For many companies, customer emissions are much larger than their direct and operational emissions, so investors keep a keen eye on target setting in this area, as an indication that boards are addressing this primary carbon reduction challenge. BHP has been notable amongst the diversified miners in this regard, announcing in July that it will set and disclose goals in 2020 to tackle emissions from customers that use its iron ore and coking coal for steelmaking and other products.

Carmakers in the US

LAPFF alongside other investors has been engaging both Ford and General Motors (GM) on their approach to climate change, which became more pressing with the US administration planning a roll-back on fuel efficiency standards. LAPFF and other investors were initially calling on companies to engage with the federal government but also with California. The Forum had previously written to the companies to continue to work with California on agreed standards to reduce greenhouse gas emissions regardless of the federal approach. GM responded to a separate correspondence from the investor coalition outlining their investment in electric vehicles and stating that they were encouraging a negotiated national solution. However, there was a more positive response from Ford alongside BMW, Volkswagen and Honda who have agreed a deal with California on fuel efficiency standards. The Forum wrote to those companies thanking them for their agreement to voluntarily comply with California's rules while also calling on GM to follow suit. This agreement is a major win for the Forum and will potentially have significant environmental and economic benefits for all stakeholders.

SOCIAL RISK ENGAGEMENTS DIVERSITY

Aveva Group

LAPFF has identified the technology sector as having particularly low levels of women represented on company boards and therefore has focused diversity engagements in this sector. As part of this engagement strand, the Forum spoke with the Philip Aiken (pictured), chair of UK-based technology company Aveva, to gain a better understanding of how Aveva is tackling management of diversity throughout the company as well as any target setting on gender diversity in particular. Mr Aiken provided a clear outline of measures the company was taking in recruiting and retaining women in Aveva's workforce and the approach to boardroom appointments, with the latest appointments split equally between men and women. Further improvement in board level diversity is unlikely in the short-term, with no board appointments imminent, leaving the company still falling short of 30% female board representation mark.

COLLABORATIVE ENGAGEMENTS

Methane: regulatory oversight

Four oil and gas majors have come out publicly in support of federal methane regulation (Shell, BP, Exxon Mobil and Equinor) with Shell's statement being the strongest. Despite this, the Trump Administration is seeking to remove methane from regulatory oversight. LAPFF has supported an Investor Statement which asks a range of these 'non-renewable' companies to speak out publicly on the need to maintain both the federal regulation of methane and the US Environmental Protection Agency (EPA)'s 'Endangerment Finding'. This finding dates from 2009 and requires the EPA to take action under the Clean Air Act to curb emissions of carbon dioxide, methane and other greenhouse gases which would endanger 'the public health and welfare of current and future generations'. The Investor Statement is also being sent to a number of US Electric Power companies on the risk posed to downstream companies including Dominion, Duke, Xcel, Exelon, Southern and NRG. LAPFF has also written to the National Grid Chair with the Statement as the company has significant operations in the US distributing electricity and natural gas.

The Powering Past Coal Alliance

The government department for Business, Energy and Industrial strategy (BEIS) is working to develop Finance Principles for the UK and Canadian government-led 'Powering Past Coal Alliance'. The PPCA Finance Principles are covered in the government's new Green Finance Strategy.

LAPFF has signed up to be a partner to the 'Powering Past Coal Alliance'. This decision is in line with LAPFF policy that there should be no new investment in coal. This position will be made public in New York in late September as part of UN Climate Action Summit (pre)meetings. There will be further opportunities for

COMPANY ENGAGEMENT

LAPFF members to join PPCA through to and including COP26 in late 2020.
US Corporate Lobbying positions
Companies have significant influence on climate and energy policies and LAPFF has concerns, shared by other investors, about lobbying activities that are inconsistent with addressing the risks posed by climate change.
LAPFF, through its CERES membership, has therefore joined other signatories to an investor letter to 55 US companies to share expectations on the topic of corporate lobbying on climate change and to request information about how each company ensures that its lobbying activities are consistent with the goals of the Paris Agreement on climate change. Some members wishing to take a more active approach have taken up the opportunity to file or co-file resolutions to US companies that have been identified with significant federal and state lobbying expenditures and that lack or have poor disclosure on trade association memberships.

POLICY ENGAGEMENTS

Reliable accounts updates

There have been few developments in this area since the last Quarterly Engagement Report, other than the fact that the new Chair of the Audit, Reporting and Governance Authority (ARGA) has been announced as Simon Dingemans.

Further to the penalties on Tesco plc, following accounting irregularities in 2014, LAPFF has again approached the Financial Conduct Authority (FCA) and a meeting between the LAPFF Chair and the FCA is pending. LAPFF made the point that the system the FCA had used, compensating one class of shareholder at the cost of another, was disadvantageous to long-term shareholders.

As part of an investor group led by Sarasin & Partners LLP, LAPFF attended a meeting with PwC about the extent to which auditors are able to provide assurance that companies are accounting for material climate risks. The concern is whether audit committees, as well as the auditors themselves, are able to ensure that a company's financial statements convey a true and fair view of the businesses financial performance if climate considerations are not adequately disclosed. The balance sheets of oil and gas companies (now classified as 'non-renewables') are particularly at risk of potential overstatement given the increase in risk of asset depreciation consequent to changes in government policies, technological advances and public opinion amongst other factors. PwC acknowledged the role of the auditor in reporting climate risks. It became apparent during the discussion that the primary obstruction to consistency in reporting climate risks originates from the judgement auditors make around whether financial statements that do not outline climate change as a material risk remain compliant with reporting requirements.

Investing in a Just Transition to a Net Zero Economy – What needs to change?

Changes to secure investment in the Just Transition were discussed at the Liberal Democrat, Conservative and Labour conferences. Organised by the Smith Institute, the meetings provided a platform for LAPFF to set out what these changes should be. Both the LAPFF Chair, Cllr Doug McMurdo and Vice-chair, Cllr Rob Chapman identified that partnership is critical to the success of the Just Transition. So a core recommendation from LAPFF was that the UK government should establish a Just Transition Commission, along the lines of the Scottish Commission, to bring public and private sectors together.

A consensus from the Liberal Democrat meeting was that there needed to be much more certainty around environmental regulation and policy to support the move to a net zero economy in a just way. The regulatory environment was also central to discussions at the Conservative fringe meeting with a call for greater cross government collaboration and a dedicated cabinet minister and governmental department. At the Labour meeting, there was agreement that the target of net zero emissions by 2030 achieved in a 'just' way was ambitious and that there should be focus on making as much progress in the short term as possible.

MEDIA COVERAGE

Pension fund anger at Sports Direct's Mike Ashley: 'There's a problem here'
Yahoo! Finance, 11 September 2019
A third of Sports Direct investors vote against re-electing Mike Ashley
The Guardian, 11 September 2019
Sports Direct in race against time to find new auditor
Financial Times, 11 September 2019
Sports Direct shares recover some losses
The BBC News, 29 July 2019
Results debacle hits Sports Direct shares
The Times, 30 July 2019
Investors urge cement makers to cut emissions
Financial Times, 21 July 2019
Super Fund corrals $13trn for livestreaming action
Newsroom, 20 August 2019
Germany and Slovakia head list of new Alliance members at UN Climate Action Summit
Powering Past Coal Alliance, 22 September 2019
Inside view: How to be an effective steward of assets
Funds Europe Magazine, 25 September 2019

NETWORKS AND EVENTS

ClientEarth 'Climate Change and the Law' Seminar - This event explored how to use the existing legal framework to better encourage companies to report both on their climate change impacts and on how they will be affected by climate change.
LAPFF attended the launch of the FAIRR Protein Producer Index. The Index benchmarks the largest global meat, dairy and aquaculture producers using environmental, social and governance risk factors in line with the Sustainable Development Goals.

● The processing of 70 billion animals for human consumption annually is responsible for 14% of the world's greenhouse gas emissions.
Jeremy Coller - Coller FAIRR Protein Producer Index

COMPANY PROGRESS REPORT

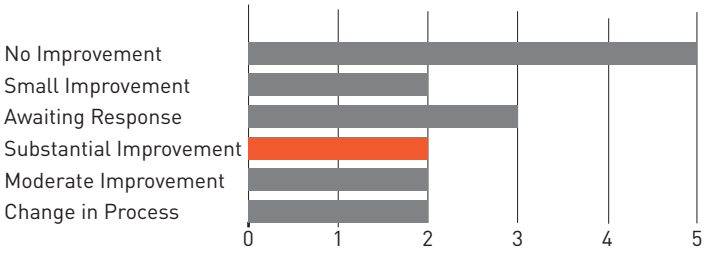
108 Company engagements over the quarter including the following meetings, voting alert submissions and filing of shareholder resolutions

Company	Activity	Topic	Outcome
ARCELORMITTAL SA	Meeting	Climate Change	Change in Process
BAE SYSTEMS PLC	Meeting	Human Rights	No Improvement
CENTRICA PLC	Meeting	Climate Change	Substantial Improvement
GENERAL MOTORS COMPANY	Meeting	Environmental Risk	Small improvement
GLENCORE PLC	Meeting	Audit Practices	Small Improvement
NATIONAL GRID PLC	AGM	Climate Change	Substantial Improvement
PETROBRAS-PETROLEO BRASILIERO	Meeting	Reputational Risk	Moderate Improvement
RYANAIR HOLDINGS PLC	Alert Issued	Governance (General)	
SOUTHERN COMPANY	Meeting	Climate Change	Change in Process
SPORTS DIRECT INTERNATIONAL PLC	Alert Issued	Governance (General)	
WALT DISNEY	Resolution filed	Climate Change	Dialogue

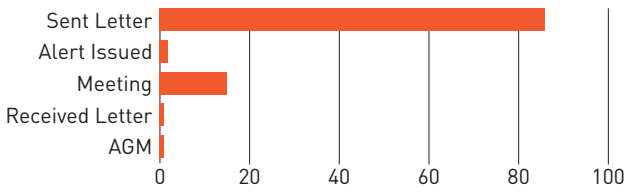
SUBSTANTIAL IMPROVEMENTS: Centrica plans to exit oil and gas production, including selling its stake in Cuadrilla which operates fracking operations in Lancashire. **National Grid** is joining the Powering Past Coal Alliance, which had been a request at the last meeting with the company.

ENGAGEMENT DATA

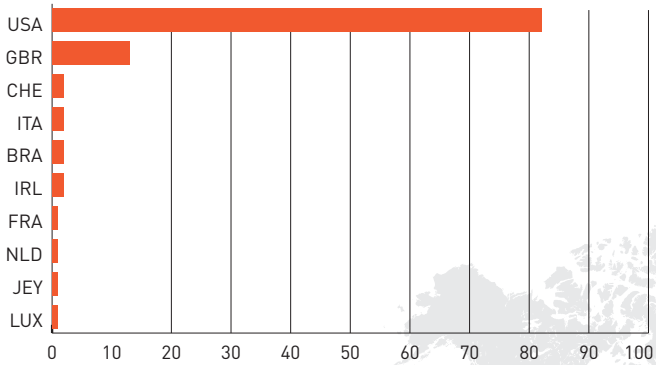
MEETING ENGAGEMENT OUTCOMES



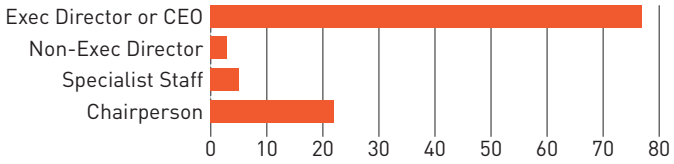
ACTIVITY



COMPANY DOMICILES



POSITIONS ENGAGED



ENGAGEMENT RE YEMEN

The reputational damage facing local authority funds as a result of holding Aerospace and Defence companies has been outlined.

LOCAL AUTHORITY PENSION FUND FORUM MEMBERS

Avon Pension Fund
Barking and Dagenham Pension Fund
Barnet Pension Fund
Bedfordshire Pension Fund
Border to Coast Pensions Partnership
Brunel Pensions Partnership
Cambridgeshire Pension Fund
Camden Pension Fund
Cardiff & Glamorgan Pension Fund
Cheshire Pension Fund
City of London Corporation Pension Fund
Clwyd Pension Fund (Flintshire CC)
Cornwall Pension Fund
Croydon Pension Fund
Cumbria Pension Fund
Derbyshire Pension Fund
Devon Pension Fund
Dorset Pension Fund
Durham Pension Fund
Dyfed Pension Fund
Ealing Pension Fund
East Riding Pension Fund
East Sussex Pension Fund
Enfield Pension Fund
Environment Agency Pension Fund
Falkirk Pension Fund
Gloucestershire Pension Fund
Greater Gwent Pension Fund
Greater Manchester Pension Fund
Greenwich Pension Fund
Gwynedd Pension Fund
Hackney Pension Fund
Hammersmith and Fulham Pension Fund
Haringey Pension Fund
Harrow Pension Fund
Havering Pension Fund
Hertfordshire Pension Fund
Hounslow Pension Fund
Islington Pension Fund
Kingston upon Thames Pension Fund
Lambeth Pension Fund
Lancashire County Pension Fund
Leicestershire Pension Fund
Lewisham Pension Fund
LGPS Central
Lincolnshire Pension Fund
London CIV
London Pension Fund Authority
Lothian Pension Fund
Merseyside Pension Fund
Merton Pension Fund
Newham Pension Fund
Norfolk Pension Fund
North East Scotland Pension Fund
North Yorkshire Pension Fund
Northern LGPS
Northamptonshire Pension Fund
Northumberland Pension Fund
Nottinghamshire Pension Fund
Oxfordshire Pension Fund
Powys Pension Fund
Redbridge Pension Fund
Rhondda Cynon Taf Pension Fund
Shropshire Pension Fund
Somerset Pension Fund
South Yorkshire Pension Authority
Southwark Pension Fund
Staffordshire Pension Fund
Strathclyde Pension Fund
Suffolk Pension Fund
Surrey Pension Fund
Sutton Pension Fund
Swansea Pension Fund
Teesside Pension Fund
Tower Hamlets Pension Fund
Tyne and Wear Pension Fund
Wales Pension Partnership
Waltham Forest Pension Fund
Wandsworth Borough Council Pension Fund
Warwickshire Pension Fund
West Midlands ITA Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund•
Westminster Pension Fund
Wiltshire Pension Fund
Worcestershire Pension Fund

Worcestershire Pension Fund

Hermes EOS

Over the last quarter we made voting recommendations at **24** meetings (**207** resolutions). At **ten** meetings we recommended opposing one or more resolutions. We supported management on all resolutions at the remaining **14** meetings.

Global

We made voting recommendations at **24** meetings (**207** resolutions) over the last quarter.

Total meetings in favour **58.3%**

Meetings against (or against AND abstain) **41.7%**

Emerging and Frontier Markets

We made voting recommendations at **24** meetings (**207** resolutions) over the last quarter.

Total meetings in favour **58.3%**

Meetings against (or against AND abstain) **41.7%**

The issues on which we recommended voting against management or abstaining on resolutions are shown below.

Global

We recommended voting against or abstaining on **26** resolutions over the last quarter.

- Board structure **11.5%**
- Remuneration **30.8%**
- Shareholder resolution **19.2%**
- Capital structure and dividends **23.1%**
- Amend articles **15.4%**

Emerging and Frontier Markets

We recommended voting against or abstaining on **26** resolutions over the last quarter.

- Board structure **11.5%**
- Remuneration **30.8%**
- Shareholder resolution **19.2%**
- Capital structure and dividends **23.1%**
- Amend articles **15.4%**

Worcestershire Pension Fund

Hermes EOS

Engagement by region

Over the last quarter we engaged with **29** companies held in the Worcestershire Pension Fund portfolios on a range of **64** environmental, social and governance issues and objectives.

Global

We engaged with **29** companies over the last quarter.

- Environmental **26.6%**
- Social and Ethical **23.4%**
- Governance **18.8%**
- Strategy, Risk and Communication **31.2%**

Developed Asia

We engaged with **13** companies over the last quarter.

- Environmental **24.0%**
- Social and Ethical **36.0%**
- Governance **16.0%**
- Strategy, Risk and Communication **24.0%**

Emerging & Developing Markets

We engaged with **16** companies over the last quarter.

- Environmental **28.2%**
- Social and Ethical **15.4%**
- Governance **20.5%**
- Strategy, Risk and Communication **35.9%**

Engagement by theme

Over the last quarter we engaged with **29** companies held in the Worcestershire Pension Fund portfolios on a range of **64** environmental, social and governance issues and objectives.

Environmental

Environmental topics featured in **26.6%** of our engagements over the last quarter.

- Climate Change **70.6%**
- Forestry and Land Use **11.8%**
- Pollution and Waste Management **17.6%**

Social and Ethical

Social and Ethical topics featured in **23.4%** of our engagements over the last quarter.

- Conduct and Culture **13.3%**
- Human Capital Management **33.3%**
- Human Rights **33.3%**
- Labour Rights **20.0%**

Governance

Governance topics featured in **18.8%** of our engagements over the last quarter.

- Board Diversity, Skills and Experience **50.0%**
- Board Independence **8.3%**
- Shareholder Protection and Rights **25.0%**
- Succession Planning **16.7%**

Strategy, Risk and Communication

Strategy, Risk and Communication topics featured in **31.2%** of our engagements over the last quarter.

- Audit and Accounting **5.0%**
- Business Strategy **40.0%**
- Integrated Reporting and Other Disclosure **20.0%**
- Risk Management **35.0%**

Notices:
The data presented here relate to voting decisions for listed securities held in Worcestershire Pension Fund portfolios.

Meeting Date	Company Name	Meeting Type	Voting Action	Agenda Item Numbers	Voting Explanation
21/08/2019	China Gas Holdings Limited	Annual	Against	8 6 7	Apparent failure to link pay and appropriate performance Concerns to protect shareholder value Issue of equity raises concerns about excessive dilution of existing shareholders
01/08/2019	Raia Drogasil SA	Special	All For		
30/08/2019	Banco Bradesco SA	Special	All For		
30/08/2019	Banco Bradesco SA	Special	Against	1	
30/08/2019	Banco Bradesco SA	Special	All For		
13/09/2019	NetEase, Inc.	Annual	All For		
27/09/2019	Inner Mongolia Yili Industrial Group Co., Ltd.	Special	Against	2,3,4	Apparent failure to link pay and appropriate performance
02/08/2019	Housing Development Finance Corporation Limited	Annual	Against	8 7	Lack of independence on board Lack of independence on board 2- Overboarded/Too many other time commitments
06/08/2019	HCL Technologies Limited	Annual	All For		
07/08/2019	Mahindra & Mahindra Ltd.	Annual	All For		
27/08/2019	Maruti Suzuki India Limited	Annual	All For		
27/08/2019	Power Grid Corporation of India Limited	Annual	All For		
28/08/2019	Colgate-Palmolive (India) Limited	Annual	All For		
21/09/2019	HCL Technologies Limited	Court	All For		
23/09/2019	ITC Limited	Special	All For		
24/09/2019	Indraprastha Gas Limited	Annual	All For		
28/08/2019	PT Bank Mandiri (Persero) Tbk	Special	Against	1	
30/08/2019	PT Bank Negara Indonesia (Persero) Tbk	Special	Against	1	
02/09/2019	PT Bank Rakyat Indonesia (Persero) Tbk	Special	Against	1,2	
18/09/2019	NICE Ltd. (Israel)	Annual	Against	2a.1,2b.1,3a,4a	Administrative declaration
30/09/2019	Rosneft Oil Co.	Special	All For		
23/08/2019	Naspers Ltd.	Annual	Against	8 7 5 6 9 10	Apparent failure to link pay & appropriate performance Apparent failure to link pay & appropriate performance Concerns to protect shareholder value Issue of capital raises concerns about excessive dilution of existing shareholders Issue of capital raises concerns about excessive dilution of existing shareholders 2- Multiple voting rights Multiple voting rights
23/08/2019	Naspers Ltd.	Special	All For		
28/08/2019	Mr. Price Group Ltd.	Annual	Against	7,8 2.3	Apparent failure to link pay and appropriate performance Concerns about remuneration committee performance

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worcestershire countycouncil

AGENDA ITEM 11

PENSIONS COMMITTEE
13 DECEMBER 2019

RISK REGISTER

Recommendation

1. The Chief Financial Officer recommends that the Committee comment and note the WPF Risk Register as at the 2 December 2019.

Background and update

2. The Risk Register is kept under regular review and, following the December 2019 review by officers, an updated Register is attached as an Appendix.

3. There have been no amendments to the Risk register over this period apart from updating the mitigation in relation to Risk WPF 11 – Failure to pool assets using LGPS Central. The following has been added after discussions at the last Committee. *The Fund will monitor the willingness of the Pool to invest in the sort of assets that could have a positive impact on the Fund's future funding levels.*

4. Other Mitigating actions have been updated for actions that have been completed or changes to timelines

Supporting information

- Appendix - WPF Risk Register 2 December 2019

Contact Points

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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 Pension Fund

Risk Register

As at 02 12 2019

About this Risk Register

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).

The far-right column, Residual Risk Score, includes upwards or downwards arrows if the score has changed since the previous Risk Register (as at 19 09 2019 in this case).

In the far-right column, Residual Risk Score, the scores in brackets below the current score indicate what the previous score was if the score has changed since the previous Risk Register.

The risks logged in this register are (in highest Residual Risk Score order):

- Mismatch in asset returns and liability movements.
- Failure to pool assets using LGPS Central Limited.
- Employers cannot pay their contributions or take on an inappropriate level of risk or their contributions take them too close to limits of their available expenditure.
- Being reliant on LGPS Central Limited delivering its forecasted cost savings.
- Fair Deal consultation proposals being implemented.
- Failure to procure a pensions admin system for the future.
- Employers having insufficient skilled resources to supply our data requirements.
- Failure to appoint suitable investment managers and review their performance / markets / contracts.
- Failure of officers to maintain sufficient level of knowledge / competence.
- Failure of existing pension admin system to deliver the services contracted.
- Staff leaving or going on long term absence.
- Failure of business continuity planning.
- Cyber-attack leading to loss of personal data like bank account details.
- Failure to maintain the quality of our data.
- Future change to LGPS regulations or other legislation, for example the LGPS cost cap, the SAB's governance working groups, or the 'Restricting exit payments in the public sector' / 'Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk' consultations.
- 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.
- Being reliant on LGPS Central Limited's investment approach following transitioning of assets.
- Insufficient knowledge amongst members of Pensions Committee / Pension Board / Pension Investment Sub Committee members.
- Failure to disclose relevant facts in the Annual Report or during audit(s).
- Liquidity / cash flow is not managed correctly.
- Failure to exercise proper stewardship of the Fund's assets.
- Fraud by staff.
- Failure of governance arrangements to match up to recommended best practice.
- Failure of custodian to deliver the services contracted.
- Not having an established and meaningful Business Plan / Pension Administration Strategy.
- Failure of the actuary to deliver the services contracted.
- Failure of investment adviser to deliver the services contracted.
- Fraud by scheme members.
- Incorrect calculation of benefits through human error or delayed notification of a death.
- Failure to deliver member communications in line with regulatory requirements, for example the 31 August annual benefit statement deadline.

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual 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. The Equity Protection arrangements have been extended for a further 12 months to Sep 2020 as part of the investment strategy review. 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. Monthly Investment Working Group meetings are held between the partner funds and LGPSC to explore new fund opportunities.	25	2	50 RED

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
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 and monitors the willingness of the pool to invest in the sort of assets that could have a positive impact on the Fund's future funding levels. The first transfer of Fund assets (in emerging markets) was undertaken in July. Transfer of the Fund's corporate bond assets is planned for Jan 2020.	20	2	40 AMBER

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
WPF 23 (Chief Financial Officer)	Employers cannot pay their contributions or take on an inappropriate level of risk or their contributions take them too close to limits of their available expenditure.	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 in the process of making annual covenant reviews mandatory, of introducing employer grouped investment strategies and working with at risk employers.	20	2	40 AMBER

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual 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.	15	3	45	The Pension Investment Sub Committee monitors the costs of being a partner fund of LGPS Central Limited. LGPS Central's Practitioners' Advisory Forum (PAF) 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 on 19 Mar to follow up on raising its concerns on 28 Nov 2018. LGPS Central's new Chief Executive is meeting with all partner funds and will formally respond to concerns at the October Pensions Committee meeting. An update on the forecast cost savings and cost sharing model should be available by 31 December.	15	2	30 A M B E R
WPF 06 (Chief Financial Officer)	Fair Deal consultation proposals being implemented.	Increasing administrative complexity.	15	3	45	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.	15	2	30 A M B E R

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
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	To react to the WCC roll out of Windows 10 and the fact that Altair, the current pensions administration system, needs to be moved off the Oracle platform, the hosting of Altair has been moved from WCC servers to a cloud solution supplied by Aquila Heywood, the supplier of Altair, on an interim basis pending the existing arrangement being decommissioned Jun 2020. In the long term once a national LGPS framework for pension admin systems is available the Fund will make use of it.	15	2	30 AMBER

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual 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 has reminded employers about their responsibilities by launching 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) on 1 April 2019 and supports employers with monthly newsletters / its website / employer fora. Officers are developing a 'New to the LGPS?' employer workshop and an employer workshop on 'Form Completion' to follow up on the 'Pensions Development Pathway', employers 'How to' and the 'What the Fund expects from its employers' calendar that were launched in May. We have met with a sample employer to ascertain what implications offering the LGPS has for them and how we could make life easier for our employers. Checking individual records at points of significant transaction.	15	2	30 AMBER

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual 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 Sub Committee has been introduced to deliver more effective decision making: its predecessor, the Pension Investment Advisory Panel, had to have its recommendations approved by the Pensions Committee. It monitors performance of the Fund's diverse range of investment managers, meeting with / placing managers on watch as appropriate. It and Fund officers carry out a subjective review and objective analysis of asset performance and take advice from the investment adviser, LGPS Central Limited / its partner Funds. Contract service is reviewed quarterly by the Pension Investment Sub Committee. The Finance Manager - Pensions reviews investment managers' internal control reports and reports any significant exceptions to the Chief Financial Officer.	25	1	25 A M B E R
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 as part of the Worcestershire County Council whole organisation redesign.	25	1	25 AM- BER

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
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 Administration Strategy reminds employers of their responsibility to provide accurate and timely information on pay. To react to the WCC roll out of Windows 10 and the fact that Altair, the current pensions administration system, needs to be moved off the Oracle platform, the hosting of Altair has been moved from WCC servers to a cloud solution supplied by Aquila Heywood, the supplier of Altair, on an interim basis pending the existing arrangement being decommissioned Jun 2020. In the long term once a national LGPS framework for pension admin systems is available the Fund will make use of it.	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. The 2019 annual performance review cycle was used to discuss informal succession planning.	25	1	25 AMBER

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
WPF 21 (Chief Financial Officer)	Failure of business continuity planning.	Inability to deliver critical functions like paying pensioners.	25	2	50	The Fund and Worcestershire County Council (WCC) 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 AM-BER
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. Regular meetings are being set up with WCC IT Infrastructure. Systems are 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 30 (HR Service Centre Manager)	Failure to maintain the quality of our member data	Paying incorrect or no benefits / problems with the Pensions Regulator / reputational or financial loss.	25	2	50	We commission annual checks on the quality of our data and use the findings to target correcting those areas where our data is not of the highest quality.	25	1	25 AM-BER

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
WPF 07 (Chief Financial Officer)	Future change to LGPS regulations or other legislation, for example from the LGPS cost cap, the SAB's governance working groups, or the 'Restricting exit payments in the public sector' / 'Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk' consultations.	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 the Chair of the LGPS Scheme Advisory Board. Our actuary is using individual member data when providing FRS data for individual employers' accounts. The Fund is in the process of making annual covenant reviews mandatory, of introducing employer grouped investment strategies and working with at risk employers.	20	1	20 GREEN
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 employer 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 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 Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
WPF 09 (Chief Financial Officer)	Being reliant on LGPS Central Limited's investment approach following transitioning of assets.	Investment underperformance / regulatory non-compliance.	25	2	50	Emerging market assets were transferred in July 2019 and corporate bonds are expected to be transferrred in Jan 20. The Pension Investment Sub Committee 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.	20	1	20 GREEN
WPF 02 (Chief Financial Officer)	Insufficient knowledge amongst members of Pensions Committee / Pension Board / Pension Investment Sub Committee members.	Poor decision-making / scrutiny.	15	2	30	Training policy, sessions and plans have been implemented in line with the Chartered Institute of Public Finance and Accountancy (CIPFA) knowledge and skills framework / best practice guidance to include induction training sessions for new members and quarterly ongoing training for all members. Training sessions were delivered in Sep 2018, Dec 2018, July 2019 and Nov 2019. The next training session will be in Feb 2020.	15	1	15 GREEN

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual 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 Public Finance and Accountancy (CIPFA) example accounts and external audit accounts checklist. The 2019 statement of accounts has been signed off by the Fund's auditors.	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 Sub Committee monitors Environmental, Social and Governance (ESG) policy regularly.	15	1	15 GREEN

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual 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 GR-EEN
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 updated its Governance Compliance Statement on 19 March 2019. This is included in the 2019 annual report. That report is signed off by its auditors. The Fund has replaced the Pension Investment Advisory Committee with a Pension Investment Sub Committee of the Pensions Committee that has decision making authority. The Fund is monitoring the SAB good governance working groups.	5	1	5 GREEN
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. Audits have been completed in 2019.	5	1	5 GR-EEN
WPF 04 (Chief Financial Officer)	Not having an established and meaningful Business Plan / Pension Administration Strategy.	Poor decision making and delays in responding to stakeholders e.g. elected members.	5	4	20	Pension admin KPIs / investment performance / project summaries are included in the Business Plan 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 has been in place since 1 April 2019.	5	1	5 GREEN

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
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 GR-EEN
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 requires a member signature as authorisation and does not take instructions over the phone. A signed form or instruction can be scanned and emailed to the Fund. Telephone callers are asked questions to check that they are who they claim to be. 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). The Fund has actioned its 2019 information from NFI.	5	1	5 GREEN

WPF Risk Register as at 2 Dec 2019 Risk Reference (owned by)	Description of Risk	Leading to	Gross Impact	Gross Prob-ability	Gross Risk Score	Mitigating Action	Resi-dual Impact	Resi-dual Prob-ability	Resi-dual Risk Score
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

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worcestershire countycouncil

AGENDA ITEM 12

PENSIONS COMMITTEE
13 DECEMBER 2019

PENSION FUND TRAINING PROGRAMME

Recommendation

1. The Chief Financial Officer recommends that:

a) The feedback from the Pensions Training event on the 28 November attached as Appendix 1 be noted; and

b) The Training plan (Appendix 2) 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 the 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 has continued to be developed for the Pension Committee, Pension Sub Committee and Board Members up to April 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. It is noted that there have been a number of changes at Committee and Board, and subject to any further reviews of Governance discussed elsewhere on the same agenda as this paper there may be more. As a result it is proposed to run a number of refresher and catch up training programmes for those members of the Committee and Board.

9. A training event was provided to members of the Committee and the Pension Board on the 28 November 2019 and the formal feedback from this event is detailed in Appendix 1. The events were well received, and eight out of twenty members attended. There was also an LGPS Central Infrastructure event in Birmingham on the 26 November 2019 and 3 members attended. Feedback will be provided as soon as this is received.

Contact Points

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Worcestershire Hub: 01905 765765

Specific Contact Points for this report
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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 the Pension Committee on the 22 June 2018

Training Evaluation Form

Title of event: Pensions Admin & Investment Training

Date of event: 28th November 2019

Location of event: Council Chamber, County Hall, Worcestershire

Trainers: Macquarie, Invesco and Rob Wilson and Philip Hebson (MJ Hudson)

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	7	1			
2. The presenters were engaging	4	4			
3. The presentation materials were relevant	6	2			
4. The content of the course was organised and easy to follow	5	3			
5. The trainers were well prepared and able to answer any questions	6	2			
6. The course length was appropriate	5	3			
7. The pace of the course was appropriate to the content and attendees	4	4			
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	6	2			

10. Will you be able to use this training to help in your Committee / Board duties?	6	2			

10. What was most useful?

Benchmarking
- I enjoyed the diversity of the different training slots and elements of the sessions will be useful for Board / Committee duties
- All presenters were very good and provided a good insight into their topic
- Discussions on Retail investment
- Hearing from Fund managers
- All elements helpful.

11. What was least useful?

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?

- Further allocation of risk per asset allocations
- More ethical issues considered

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

- Yes, Good introduction to risk vs returns in pension investments
- Important to understand risk
- Very useful and interesting

14. Any other comments?

- Still concerned that Climate change is not being identified as a risk to funds
- Not always easy to hear what was being said.
- All very useful
- Thanks for an enjoyable afternoon

THANK YOU FOR COMPLETING THIS EVALUATION FORM. FEEDBACK RECEIVED WILL BE USED TO PROVIDE IMPROVEMENTS TO FUTURE EVENTS.

EVALUATION FORMS SHOULD BE HANDED TO THE TRAINERS AT THE END OF THE EVENT. ALTERNATIVELY FORMS CAN BE SUBMITTED TO RWilson2@worcestershire.gov.uk

Worcestershire Pension Fund **Appendix 2**

Proposed Training Programme for Pension Committee, Investment Sub Committee & Board Members

	Training Topics	19/06/2019	08/07/2019	28/11/2019	04/02/2020	03/04/2020	TBA
	Investments						
1	Investment pooling – An update on progress						
2	Joint working – An update on progress						
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						
5	Equities (including sustainable equities)						
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 (ESG)				Y		
14	The Investment Regulations					Y	
15	Performance and risk management of a pension fund (PEL & CEM Benchmarking)	Y					Y
	Administration and Governance						
16	Guaranteed Minimum Pension (GMP)						
17	The role of the Pensions Regulator					Y	
18	Administrative Authority Lifecycle overview						
19	Covenant Monitoring						
20	Data protection / personal data retention policy / data quality				Y		
21	Actuarial valuations, Triennial Review, Funding Strategy Statement and Employer Risk Framework	Y					
22	Administrative processes and Lifecycle (Part one and Two) See below for topics		Y			Y	Y
23	Demonstration of website developments and an introduction to possible future digital developments				Y		
24	knowledge of the duties and responsibilities of committee members & Role of Trustee				Y		
25	Data quality						
26	Pension accounting and audit requirements						Y
27	Corporate Governance and shareholder activism, including the Myners Principles (May be covered via Responsible Investment above)					Y	

Worcestershire Pension Fund **Appendix 2**

Proposed Training Programme for Pension Committee, Investment Sub Committee & Board Members

Training Topics	19/06/2019	08/07/2019	28/11/2019	04/02/2020	03/04/2020	TBA
Administration Lifecycle		Part Two			Part One	Part Two
		08/07/2019			03/04/2020	TBC
• Employers					Y	
• Membership					Y	
• Leavers					Y	
. Transfers in and Out					Y	
Additional Voluntary Contributions (AVC)'s and Pension Contributions (APC's)		Y				Y
Nominations		Y				Y
Divorce		Y				Y
Decisions and Appeals (IDRP) & The Pensions Ombudsman		Y				Y
The starters process and / or the leavers process						Y

worcestershire countycouncil

AGENDA ITEM 13

PENSIONS COMMITTEE
13 DECEMBER 2019

FORWARD PLAN

Recommendation

1. **The Chief Financial Officer recommends that the Committee comment and approve the Forward Plan.**

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 Committee.

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:

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Pensions Committee Proposed Forward Plan

Appendix

Pension committee Items	13/12/2019	31/01/2020	17/03/2020	26/06/2020	09/10/2020
LGPS Central Update	Y		Y	Y	Y
LGPS Central Budget and Strategic Business Plan		Y	Y		
Pension investment Update	Y		Y	Y	Y
Pension Key Performance Indicators (Within Business Plan Report)	➡	Y	Y	Y	Y
Pension fund Unaudited Annual Report				Y	
Pensions Final External Audit Report on Annual Report					Y
Pension fund administration Budget Approval			Y		
Pension fund administration Budget Monitoring			Y		Y
Government Actuary Dept (GAD) review update					Y
Members Training update	Y		Y	Y	Y
Investment Strategy Statement update			Y		
Strategic Asset Allocation Review	Y				
Administrative Authority update	➡	Y	Y	Y	Y
Equity Protection update			Y		
Risk Register	Y		Y	Y	Y
Actuarial Valuation and Funding Strategy Statement	Y				
Business Plan and Business Plan Monitoring	➡	Y	Y	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
Governance and Investment Advisors objectives	Y				
Stewardship Code Compliance Statement	➡	Y			
Pensions Committee & Investment advisory Panel terms of Reference			Y		
Admin Strategy (Flows into Business Plan where actions are)			Y		

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