Agenda

AGENDA for a meeting of the PENSIONS COMMITTEE to be held in COMMITTEE ROOM A, County Hall, Hertford on TUESDAY, 27 JUNE 2017 at 11:30AM

MEMBERS OF THE COMMITTEE (10) - QUORUM 3

S J Boulton, D S Drury, J M Graham, C M Hayward (Vice- Chairman), J G L King, A J S Mitchell, R G Parker, S Quilty, R Sangster, J D Williams (Chairman)

REPRESENTATIVES OF HERTFORDSHIRE DISTRICT / BOROUGH COUNCILS (3) (NON-VOTING)

J Lloyd, K Ayling, M Freeman

Invitees:

Colm O'Callaghan, District Finance Representative

Meetings of the Committee are open to the public (this includes the press) and attendance is welcomed. However, there may be occasions when the public are excluded from the meeting for particular items of business. Any such items would be taken at the end of the public part of the meeting and listed under "Part Two ('closed') agenda".

Committee Room A is fitted with an audio system to assist those with hearing impairment. Anyone who wishes to use this should contact main (front) reception.

Members are reminded that all equalities implications and equalities impact assessments undertaken in relation to any matter on this agenda must be rigorously considered prior to any decision being reached on that matter.

Members are reminded that:

(1) if they consider that they have a Disclosable Pecuniary Interest in any matter to be considered at the meeting they must declare that interest and must not participate in or vote on that matter unless a dispensation has been granted by the Standards Committee;

(2) if they consider that they have a Declarable Interest (as defined in paragraph 5.3 of the Code of Conduct for Members) in any matter to be considered at the meeting they must declare the existence and nature of that interest but they can speak and vote on the matter

PART I (PUBLIC) AGENDA

1. **MINUTES**

   To confirm the minutes (Parts I) of the Pensions Committee meeting held on 31 March 2017.

2. **PENSIONS COMMITTEE WORK PLAN FOR REMAINDER OF 2017-18**

   Report of the Director of Resources

3. **RISK AND PERFORMANCE**

   Report of the Director of Resources

4. **PENSION FUND ASSET POOLING – ACCESS UPDATE**

   Report of the Director of Resources

5. **REVIEW OF VOTING POLICY AND IMPLEMENTATION**

   Report of Mercer

6. **INVESTMENT STRATEGY**

   Report of Mercer

PART II ('CLOSED') AGENDA

EXCLUSION OF PRESS AND PUBLIC

The Chairman will move:-

"That under Section 100(A)(4) of the Local Government Act 1972, the press and public be excluded from the meeting for the following item of business on the grounds that it involves the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A to the said Act and the public interest in maintaining the exemption outweighs the public interest in disclosing the information."

PART II ('CLOSED') AGENDA

1. **PENSION FUND – FUNDING AND INVESTMENT REPORT (Formerly PERFORMANCE REPORT) AS AT 31 MARCH 2017**

   Report of the Director of Resources

If you require further information about this agenda please contact Stephanie Tarrant,

Democratic Services Officer, on telephone no (01992) 555481 or e-mail Stephanie.tarrant@hertfordshire.gov.uk

Agenda documents are also available on the internet at:
https://cmis.hertfordshire.gov.uk/hertfordshire/Calendarofcouncilmeetings.aspx

For further information about the issues covered in these reports please contact Patrick Towey on 01992 555148.

Minutes

To: All Members of the Pensions Committee

From: Legal, Democratic & Statutory Services
Ask for: Stephanie Tarrant
Ext: 25481

PENSIONS COMMITTEE
31 MARCH 2017

ATTENDANCE

MEMBERS OF THE PENSIONS COMMITEE

R J Henry, D E Lloyd, R G Parker, P A Ruffles (substitution for C M Hayward), A M R Searing, R Sangster, A Stevenson, J D Williams (Vice-Chairman)

MEMBERS OF HERTFORDSHIRE DISTRICT/BOROUGH COUNCILS (NON-VOTING)

K Ayling, M Freeman

OTHER MEMBERS IN ATTENDANCE

D Devereux (Local Government Pension Scheme (LGPS) Pension Board and Unison Member

Upon consideration of the agenda for the Pensions Committee meeting on 31 March 2017 as circulated, copy annexed, conclusions were reached and are recorded below:

Note: No conflicts of interest were declared by any member of the Committee in relation to the matters on which conclusions were reached at this meeting.

PART I ('OPEN') BUSINESS

ACTION

1. MINUTES

1.1 Minutes (Part I and II) of the meeting of the Pensions Committee held on 7 March 2017 were confirmed as a correct record and signed by the Chairman.

2. INVESTMENT STRATEGY
[Officer Contact: Patrick Towey, Head of Specialist Accounting, Tel: 01992 555148]

2.1 Members reviewed a report which shared the proposed Investment Strategy Statement for approval.

2.2 Members heard that a cross party Member working group had been formed to review and revise the current Investment Strategy, following new regulations set in November 2016. The Member working group had been supported by the Fund's investment consultant, Nick Sykes from Mercer and officers that specialised in Environmental, Social and Governance (ESG).

2.3 Members considered and commented on the five areas of the Investment Strategy Statement as set out at Appendix A.

Introduction

2.4 Members heard that the introduction set out in writing the investment beliefs of the Committee, however, it was noted that these beliefs had been implied by the work of the Committee for a number of years.

2.5 Members queried if the meaning of diversification had been articulated more specifically in terms of asset classes and suggested that it was one way of mitigating risk. Members were informed that the Investment Strategy was a framework that set out the overall asset allocations and that policies would be developed and revised to support and implement the new Investment Strategy.

2.6 Members commented on whether risk and return should still be considered related and it was noted that as a general principle it was still valid.

2.7 It was noted that diversification could reduce volatility if all assets were held in cash. Officers explained that the investment strategy reflected the need to meet immediate liabilities such as pensions in payment and that cash was held to meet these payments. The strategy also addressed the longer term nature of the liabilities which required assets that would grow, provide income and inflationary protection and were diversified to mitigate risk. Head of Specialist Accounting

2.8 'Net of fees' was discussed and it was acknowledged that the strategy should not imply fees were unimportant and it was recognised that some fund managers were now reducing fees in recognition of the competition. Head of Specialist Accounting

2.9 Members acknowledged that whilst investments were to be made via the ACCESS pool the Investment Strategy (IS) remained the responsibility of the Committee. It was agreed that a statement would be added to the introduction about the ACCESS pool, given that it was one of the biggest changes going forward for the Fund. Head of Specialist Accounting

Investment strategy and the process for ensuring suitability of investments

2.10 Members heard that the Fund's funding level was ahead of where it was expected to be due to a number of factors including reduction in inflation, liability discount rate change and strong investment returns.

2.11 Members acknowledged the new proposed asset allocation and the new asset class of real assets which were to act as a defensive asset. It was advised that 'real' assets were not necessarily tangible assets and were assets with inflationary characteristics similar to the Fund's liabilities.

2.12 Members commented that it was a sensible strategy which no longer assumed that bonds were low risk and that it had been adjusted to recognise that the timing of bond investments was important as well as having real assets with long-term growth.

2.13 Members commented that whilst the strategy had now moved forward, it was important for it to continue to meet future requirements. It was advised that part of the review highlighted the importance of keeping the strategy as a living document. The aim was to review the document yearly with reviews considered by the Committee.

Risk measurement and management

2.14 Members were given an overview of the risks that the Fund was exposed to and the requirement in the Investment Strategy was that the Fund explains how they were to be managed and mitigated against. It was noted that the Investment Strategy emphasised the investment risks but that there were other risks to be aware of that were referred to in other statements i.e. the Funding Strategy.

2.15 Members queried why there would be a demographic risk and it was advised that if the Fund reached a point in the future where there were more pensions to be paid out than contributions being received, there would need to be assets available that generated income which would enable those payments to be made.

2.16 A Member queried if a brief explanation could be provided on each asset risk and the return period and it was noted this information was covered in the risk register. Further detail from the risk register was to be provided at a future Committee meeting. Head of Specialist Accounting

Approach to asset pooling

2.17 Members heard that Hertfordshire was now one of the fund members of the ACCESS pool along with 10 other pensions funds (Essex awaiting agreement at their next meeting). The hyperlink to the ACCESS website in the report provided details and the transition and timescales.

2.18 Members discussed the liquid assets that were to be initially included Head of in the ACCESS pool and noted those that were to remain outside. It was noted that all assets would be pooled in the future and it was agreed that the strategy would recognise this. Fund of Fund fee structures would also need to be taken into in consideration to save paying triple fees. Specialist Accounting

Environmental, Social and Corporate Governance and the exercise of rights (including voting rights) policies

2.19 Members noted that a presentation had been given to the Member working group from Environmental, Social and Governance (ESG) specialists at Mercer and that they had considered how as a long-term investor the Fund could influence decisions in large companies and how the Fund engaged with investment managers.

2.20 Members were advised that there would be future consideration into how fund managers voted and whether fund managers were to be given full discretion or a proxy via a third party.

2.21 The Committee noted that fund managers had a fiduciary role to invest money where they could gain the best returns for the fund; however, it was noted that the ESG rating of each investment manager should be reviewed regularly and the investment managers held accountable.

2.22 Members commented that modern slavery should be mentioned within the ESG section of the strategy, with large organisations having to prove that they do not have any within their supply chain. Head of Specialist Accounting

2.23 Members queried if there were consistent ESG views across the ACCESS pool and heard that ACCESS officers had met to discuss ESG and it was noted that as responsible investors there may be a common policy made in the future.

2.24 The Committee Members alongside the Unison Member welcomed the ESG section of the report.

2.25 Members noted that as part of the process, the draft strategy had been shared with Members of the Pensions Board for comments. Members heard that most of the comments were around the presentation of the report and whether a percentage should be stated in terms of passive allocation. Members noted that the strategy was a living document and would be updated to meet future changes and requirements.

2.26 Members of the cross party working group and Mercer were thanked for their contribution to the revised Investment Strategy.

Decision

2.27 The Pensions Committee approved the Fund's Investment Strategy, subject to the changes as detailed above.

KATHRYN PETTITT
CHIEF LEGAL OFFICER **CHAIRMAN________________________**

HERTFORDSHIRE COUNTY COUNCIL

PENSIONS COMMITTEE

TUESDAY, 27 JUNE 2017 AT 11:30 AM

Agenda Item No:

2

PENSIONS COMMITTEE WORK PLAN FOR REMAINDER OF 2017-18

Report of the Director of Resources

Author of the report: Patrick Towey, Head of Specialist Accounting
(Telephone: 01992 555148)

1. Purpose

The purpose of this report is to provide members of the Pension Committee a plan of agenda items that will come to this Committee for the remainder of 2017-18.This report also provides new members of the Pension Committee a brief introduction to the governance of both the Local Government Pension Scheme and the Fire Fighters Pension Scheme for which Hertfordshire County Council is the administering Authority for both schemes. As a reminder for all members of the Pension Committee this report also provides a summary of a number of key policy and strategy documents which are kept under regular review by this Committee.

2. Summary

2.1 The Hertfordshire County Council Pension Committee (PC) is responsible for the administration of both the Local Government Pension Scheme (LGPS) and the Fire Fighters Pension Scheme (FFPS). The Pension Committee has its delegation direct from full Council. The Committee's role with regards to both schemes is to set the Pension Fund Objectives and determine and maintain appropriate strategies, policies and procedures with ongoing monitoring of the Fund's activities.

2.2 From 1 April 2015, the Public Service Pensions Act 2013 introduced a further layer of governance in the form of Local Pension Boards. The role of the Boards is to assist the Administering Authority (Hertfordshire County Council) to secure compliance relating to governance and administration for both the LGPS and FFPS.

2.3 Attached as appendix A to this report is the business plan of work for the remainder of 2017-18 that sets out some of the key activities that officers will be undertaking over this period and papers that will be brought before this Committee. Both the LGPS and FFPS Boards have separate work plans which will include the review of certain administration policies and proposing amendments for approval by the Pension Committee. The Pension Boards will also review decisions of the Pension Committee.

2.4 Allied to this work agenda it’s essential that the knowledge of both the members of the PC and PB is developed so that they understand and can make/scrutinise decisions diligently, training will cover a number of areas to include but not limited to: investments, actuarial assessment, policy understanding, accounting, regulatory and legal, and communications. Training will be delivered to compliment certain pieces of work that both the PC and PB may be reviewing at a particular time in the pension cycle for example the actuarial valuation of the Fund or final accounts. It is proposed that an annual business and training plan will come to both the Pension Committee and both Pension Boards for agreement on an annual basis

2.5 The Pension Committee meets six times per year; two of these meetings will be for the purpose of meeting some of the Fund’s investment managers.

3. Recommendations

3.1 That the Committee notes the content of this report.

4. Background

4.1 As Administering Authority for both the LGPS and the FFPS, the Council has delegated the responsibility for both schemes to the Pension Committee. As referred to in 2.2 the governance and administration of both schemes is supported by two local pension boards made up of equal employer and member representatives. The role of both these boards is to support and assist the PC in the delivery of its governance function and certain monitoring functions such as the oversight of the administration contract with the Local Pensions Partnership. In addition, both Boards will also review strategies and policies approved by the Pension Committee and may ask the Committee to review certain decisions.

4.2 The LGPS is a funded scheme in that contributions are made by both employers and members in the scheme; these contributions are invested through the Fund’s investment managers with the key objective of ensuring that there are sufficient funds to meet the Fund’s future liabilities. There are a number of policies and strategies that underpin the LGPS for which the Pension Committee has responsibility and a brief introduction to some of these key documents will be provided in this report.

4.3 Unlike the LGPS, the FFPS is an unfunded scheme in that members of the scheme make contributions through salary contributions and a top up grant is received from Central Government to meet any difference between income (member contributions) and expenditure (pension payments). The degree of oversight of the FFPS is reduced in that there is no investment strategy and fund manager performance monitoring to undertake and the main agenda items that will come before this Committee will be the approval of administering authority employer discretions and other member policies that are revised and need PC approval.

4.4 A forward plan of work and associated training in the form of a business plan will be brought to this committee for agreement on an annual basis. Both the FFPS and LGPS Boards will also have annual work plans and training to support their role in supporting this Committee.

4.5 From time to time a working group of cross-party members may be required to be set up to review a particular piece of work such as the Fund's investment strategy with the objective of agreeing and proposing a new strategy for recommendation to this Committee for approval.

4.6 Appendix A sets out the schedule of meetings for the Pension Committee and agenda items that will come to this Committee. The agenda will include papers that are business as usual items such as performance reporting, risk and governance, and asset pooling

5. Key Strategies and Policies

5.1 There are a number of key policies and strategy documents which need to be kept under review for both the LGPS and FFPS. These are listed below and the latest version of these reports can be found on the pension fund website https://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx .

5.2 Annual Report

This report sets out the annual accounts for the Pension Fund, LGPS, for the previous financial year. Within the annual report are the following documents:

- Administering Authority report
- Financial Statements
- Investment Report
- Funding Strategy Statement

The annual accounts will be presented to this Committee in September along with the Auditors report following the audit of the accounts. Statements and notes relating to the FFPS are contained in the main accounts of the County Council. The latest audited version of the accounts can be found on the pension fund website https://www.yourpension.org.uk/Hertfordshire/Fund-information/Annual-reports.aspx .

5.3 Funding Strategy Statement (FSS)

This sets out the strategy for prudently meeting the Fund's future pension liabilities over the longer term, including the maintenance, as far as possible, of stable levels of employer contributions. It also identifies the key risks and controls facing the Fund and includes details of employer contribution rates following the triennial valuation of the Fund. The Fund was last valued at 31 March 2016 and the current FSS was approved by the Pension Committee on 7 March 2017. The next valuation of the Fund will take place on 31 March 2019. This document is only applicable to the LGPS and not the FFPS.

5.4 Investment Strategy Statement

The Investment Strategy Statement (ISS) sets out the Hertfordshire Pension Fund’s investment objectives. The Local Government Pension Scheme (Management and Investment of Funds) regulations 2016 require all pension funds to prepare, maintain and publish an ISS. This document is designed to explain to fund members, employers and any other interested parties how the Fund’s assets are managed and the factors taken into account in so doing. The latest version of the ISS was approved by this Committee at its meeting held on 31 March 2017. This document is only applicable to the LGPS and not the FFPS.

5.5 **Communication Strategy**

This details how the Fund provides information and publicity about the Pension scheme to its existing members and their employers and methods of promoting the Pension scheme to prospective members and their employers. It also identifies the format, frequency and method of distributing such information or publicity.

5.6 **Governance Compliance Statement**

This is a written statement setting out the administering authority’s compliance with good practice governance principles. These principles are grouped within eight categories which are listed within the statement. The principles cover areas such as structure, member representation, voting, meetings etc. It also sets out the functions delegated to the Pension Committee as well as the terms of reference for both the Pension Committee and Pension Boards. This statement is prepared in accordance with the Local Government Pension Scheme Regulations 2013 which require administering authorities to maintain and publish a governance compliance statement. This statement was approved by the Pension Committee on 5 February 2016.

5.7 **Administration Strategy**

The Pension Fund is committed to providing a high quality pension service to both members and scheme employers and ensuring that the Pension Fund is effectively governed. The administration strategy sets out standards and guidelines agreed between employers and the Fund and its aim is to set out the roles and responsibilities of the Pension Fund and its scheme employers in administering the Scheme. It seeks to promote good working relationships and improve efficiency between the Pension Fund and its scheme employers.

5.8 **Administering Authority Discretions Policy**

Regulations allow the County Council as the administering authority to choose how or whether to apply certain discretions for administering the scheme and the Pension Fund. Examples of discretions include the abatement of pensions for members returning to work, the award of death grants and purchase of additional pension through additional voluntary contributions. Employer bodies within the scheme will also have their own discretionary policies to cover areas such as flexible retirement, ill health awards and early retirement without deduction of pension.

6. Forward Plan

6.1 The following Forward Plans sets out the planned activities for the remainder of 2017/18. This plan may be amended to include additional activities relating to matters that must be brought to the attention of the Pensions Committee.

6.2 The agendas on the forward plan contain part 1 and part 2 items. Part 1 items are held in public and part 2 items are held after the exclusion of press and public and contain business that involves the disclosure of exempt information.

6.3 Training will be provided to support Committee members to improve their knowledge and understanding of these activities.

Pensions Committee Forward Plan – Appendix A

Target Date	Agenda Item
27 June 2017	**PART 1**
	Risk and performance quarterly report
	Pension Committee work agenda for remainder 2017/18
	ACCESS asset pooling quarterly report
	Investment Manager voting report - Mercer report
	Investment Strategy Transition Plan – Mercer report
	PART 2
	Funding and investment quarterly report
4 September 2017	**PART 1**
	Audit Results Report – report of auditor Ernst & Young
	Response to the Audit Results Report 2016/17
	Pension Fund Annual Report and Statement of Accounts 2016/17
	ACCESS asset pooling quarterly report
	Revised Governance and Compliance Statement
	Communication Strategy
	Risk and performance quarterly report
	PART 2
	Funding and investment quarterly report
31 October 2017	**PART 2**
	Private Equity – Mercer report
	Private Equity manager presentations – managers attending tbc
29 November 2017	**PART 1**
	ACCESS asset pooling quarterly report
	Risk and performance quarterly report
	Pension Administration contract
	Pension Fund Business Plan 2017/18
	PART 2
	Annual Investment Management Costs Report
	Funding and investment quarterly report
28 February 2018	**PART 1**
	ACCESS asset pooling quarterly report
	Risk and performance quarterly report
	Treasury Management Strategy 2017/18

	PART 2
	Funding and investment quarterly report
22nd March 2018	**PART 2**
	Investment Manager presentations – managers attending tbc

HERTFORDSHIRE COUNTY COUNCIL **PENSIONS COMMITTEE** **TUESDAY, 27 JUNE 2017 AT 11:30AM**	**Agenda Item No:** **3**

RISK AND PERFORMANCE

Report of the Director of Resources

Author of the report: Jolyon Adam, Finance Manager (Telephone: 01992 555078)

1. PURPOSE OF THE REPORT

1.1 To provide the quarterly update on Risk and Performance for the Pension Fund for the period 1 January to 31 March 2017.

2. SUMMARY

2.1 The report provides an update on the following matters:

- summary of reports to be presented to the July meeting of the Pensions Boards;
- current status of risk and governance matters that are monitored as part of the Risk Register;
- current status of risk monitoring of Scheme Employers; and
- performance of the Administering Authority measured against performance indicators set out in the Administration Strategy.

3. RECOMMENDATION

That the Pensions Committee notes this report.

4. PENSION BOARD REPORTS

4.1 The Pensions Committee are invited to note the following reports related to risk and performance that the LGPS and Fire Pension Boards will receive at their July meetings:

LGPS Board

- **Risk and Governance Report:**
  - Providing a detailed quarterly update on the governance and management of the Pension Fund.
- **London Pensions Fund Authority Administration Report:**
  - Providing a quarterly update on the performance of the administration service for the Local Government Pensions Scheme.

- **Review of Pensions Board Constitution**
- **ACCESS Update**

<u>**Fire Board**</u>

- **London Pensions Fund Authority Administration Report** providing a quarterly update on the performance of the administration service for the Firefighters' Pension Scheme
- **Discretions Report** providing a review of discretions exercised during 16/17 in line with the discretions policy

5. RISK REGISTER

5.1 The Risk Register sets out risk control mechanisms that aim to either avoid or reduce the probability and/or impact of any risk event in relation to the Pension Fund. Risks are classified using the following criteria.

Risk Level	Description
Severe	The consequences will have a severe impact on the delivery of a key priority and comprehensive management action is required immediately.
Significant	The consequences of the risk materialising would be significant, but not severe. Some immediate action is required plus the development of an action plan.
Material	Consequences of the risk are not significant and can be managed through contingency plans. Action plans can be developed later to address the risk.
Manageable	Consequences of the risk are considered relatively unimportant. The status of the risk should be reviewed periodically.

5.2 Table 1 provides the risk current status of the four key risks and a summary of activities undertaken during the quarter to March 2017. The risk status key is shown in the following chart.

▲	An increase in risk status since the previous quarter
◀▶	Risk status has remained unchanged since the previous quarter
▼	A decrease in risk status since the previous quarter

Table 1: Risk Register – Current Status and Activity Summary

Risk		Risk Level	Change in Risk Status	Quarterly Activity Summary
A	The Pension Fund Investment Strategy does not deliver the long term projected investments returns and does not comply with legislation.	**Amber**	◀▶	The ACCESS proposal has been approved by Government and all 11 authorities involved have signed the inter authority agreement allowing the establishment of a joint governance committee. The Investment Strategy Statement was approved by the Pensions Committee in March 2017 and has since been published on the website. As confirmed at the previous meeting of the Pension Committee a cross-party working group has been meeting to review and revise the Fund's

				Investment Strategy. An update on the progress of this review is being provided to the Committee. Officers will work with investment advisors to develop a transition plan in relation to the 2017 Investment Strategy Statement and a separate paper will be presented in the June meeting of the Pensions Committee.
B	The funding level of the Pension Fund deteriorates.	**Amber**	◀▶	The Triennial Valuation was completed with the Actuary providing the Final Valuation report, including new certified [contribution] rates and adjustments to be effective from 31 March 2017. This document is available on the Pension Fund website. The results of the Triennial Valuation report show that the whole Fund funding level increased from 84% as at 31 March 2013 to 91% as at 31 March 2016 with an overall reduction in the deficit from £617m to £336m. A quarterly update on funding is being presented to this committee which shows the funding position changing from 91% to 92% over the course of the year to 31 March 2017.
C	Scheme employers default on meeting their obligations to the Pension Fund and LGPS.	**Amber**	◀▶	The process for the 16/17 Annual Benefit Statement exercise has now commenced, and as is being conducted on a project basis as adopted for 15/16. At this stage the majority of data has been received from employers by Local Pensions Partnership (LPP), with outstanding employers being actively pursued and subject to penalty charges. The Pensions Team have been working in conjunction with the LPP to develop a new set of Employer Surveys to ensure that information on employer bodies is kept up to date. The surveys are expected to be issued in Q1 2017/18.
D	The Pension Fund and its third party providers	**Green**	◀▶	A separate report is being presented to the committee to update on the

	do not comply with regulations, statute or procedure.			current status of asset pooling. Hertfordshire acted as the lead administering authority for the procurement of legal advice for the ACCESS pool. The tender was issued in December 2016, and the procurement process concluded in February 2017, with the contract being awarded to Squires Patton Boggs.

6. SCHEME EMPLOYERS RISK MONITORING

6.1 Scheme Employers are monitored on a monthly basis to measure the trend and current status of risk where scheme employers' covenants may have a detrimental impact on the Pension Fund.

6.2 Scheme employers are rated as:

- RED - high risk: This indicates that action is required to mitigate the risks to the Pension Fund where there is a high risk of a scheme employer defaulting on its obligations to the Pension Fund.
- AMBER - medium risk: This indicates that scheme employers require review or ongoing monitoring to determine whether any actions need to be taken to mitigate the risks identified.
- GREEN - low risk: This indicates that there are no immediate issues or actions to be taken.

Table 2 provides a summary of the current position, with comparative data for previous quarters.

Table 2: Employer Risk Monitor – Current Trend and Status

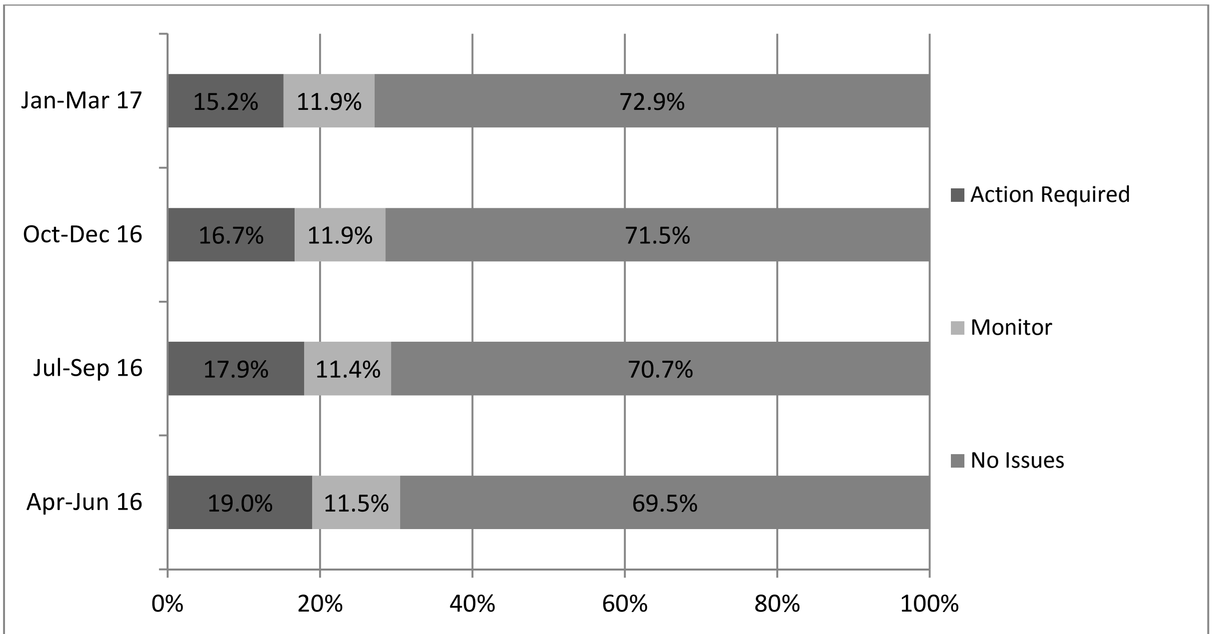

Table 3 provides an analysis of the number of scheme employers in each risk category together with the value of net liabilities for each risk category.

This analysis of the previous quarter was based on the results of the 2013 Valuation. This quarters analysis has been completed using the updated 2016 Valuation results and as the overall scheme liabilities were significantly lower in 2016 compared to 2013, the net liabilities show a large variance between quarters.

Table 3: Analysis of Scheme Employers by Risk Category

October – December 2016					Risk Category / Risk Score	January – March 2017				
Scheme Employers		Net Liabilities		Risk Score [1]		Scheme Employers		Net Assets/ Liabilities		Risk Score [1]
No.	%	£ m	%			No.	%	£ m	%	
59	16.6	(14.5)	2.4	12.22	Red (9+)	55	15.2	4.8	-1.4	12.47
42	11.9	(87.1)	14.1	4.76	Amber (4-8)	43	11.9	(66.6)	19.8	4.79
253	71.5	(515.4)	83.5	0.66	Green (0-3)	263	72.9	(274.5)	81.6	0.65
354	**100.0**	**617.0**	**100.0**	**3.09**	**Total**	**361**	**100**	**336.3**	**100**	**2.95**

A further analysis detailing employers within the ‘red’ category with outstanding admission agreements has been provided at Appendix A. This action plan sets out the original reasons for the delay in each case, the current status of the agreements and the next steps for each case.

7. ADMINISTERING AUTHORITY PERFORMANCE MONITORING

7.1 The performance of the Administering Authority and scheme employers in managing and administering the Pension Fund is measured against performance indicators set out in the Administration Strategy. This section also includes information about treasury management performance against the annual Treasury Management Strategy.

7.2 Table 4 provides the current status and commentary on the performance indicators. The performance status key is shown in the following chart.

▲	A deterioration in performance since the previous quarter
◀▶	Performance has remained unchanged since the previous quarter
▼	An improvement in performance since the previous quarter

Table 4: Administering Authority Performance Monitor

Indicator	Change in Performance Status	Commentary

[1] Calculated as an average of the individual risk scores across all employers within the category, and in total.

Audit Reviews	◀▶	The Internal Audit of Pensions Administration was finalised in Q4 2016/17 and received substantial assurance, with only two 'merits attention' recommendations. The full report is attached as Appendix B to this report. The draft 16/17 Annual Report and Accounts has been provided to the external auditor, with fieldwork scheduled for 20th June – 5th July. Currently the accounts closure process has been carried out in line with the new requirements for faster close (draft accounts need to be signed off by 31st May & audit completed by 31st July) which will come into force during 17/18. The draft Annual Report & Accounts for 16/17 was available by 26th May, and the audit is expected to be completed in advance of the 31st July trial deadline.
Complaints and Internal Disputes	◀▶	**Complaints:** During the quarter there was one new LPP service complaint, compared to two in the last quarter. Both complaints from the previous quarter were brought forward into this quarter. A complaint was received due to the member receiving a delayed response to their queries. The matter has been dealt with and the member met with Herts LPP staff where it transpired that the initial queries had been sent to an incorrect email address. All queries sent to the correct email address have been answered within Service Level Agreement. A complaint was received from a member who had received personal information regarding another member of the Herts Pension Fund. This was reported to LPP's data protection team who have offered data protection services to the member involved for 6 months. LPP will be reviewing what data is included on letters, forms and calculations as part of a wider project in the near future. The third complaint was regarding delayed retirement figures. A letter apologising to the member has been sent along with the requested information. **IDRP (Internal Dispute Resolution Process):** During the quarter to 31 March 2017, one IDRP was raised against the Administering Authority with one brought forward from the previous quarter.

		The brought forward IDRP was a stage 1 appeal regarding under-paid added years' contributions that has been turned down by the employer and has now moved to stage 2. A further £500 compensation has been awarded to the member and paid. The member has now appealed under stage 2 of the procedure. The new IDRP related to incorrect advice being provided to a member by LPP in relation to re-employment earnings post retirement. This IDRP was carried forward into Q1 17/18.
Scheme Employer Late Payments and Penalty Charges	◀▶	There were 5 penalty charges raised for the period to 31 March 2017 against 2 scheme employers for late payment of contributions or late return of monthly contribution forms. There were 11 incidents of late payment by scheme employers in the quarter to 31 March 2017. Details of these late payments are reported in the LPFA's quarterly Administration Report which is presented to the Pensions Board.
LPFA Administration Service Performance Indicators	◀▶	Officers are working with the LPFA to address the backlog of Defined Benefit cases, and develop the action plan already in place to continue to reduce this backlog in light of the one-off increases arising from year-end processes. Recruitment has been undertaken to replace leavers and a project plan is being maintained to clear the backlog of cases. Proposals put forward by the Pensions Board are being considered to implement a charge on employers for late notification of leavers due to the additional administration and peaks in workload that this creates.
Treasury Management	◀▶	The average size of the portfolio at 31 March 2017 was £22.2m increasing from £17.0m in the previous quarter. This is below the cap of £35m. Interest earned in the quarter to 31st March 2017 was £13.2k increasing from £12.1k in the previous quarter. The rate of return was 0.24% decreasing from 0.29% in the previous quarter. This was 0.13% above the benchmark of the average 7 day London Interbank Bid (LIBID) rate of 0.11%

Appendix A Outstanding Admission Agreements Action Plan: As at 07.06.2017

Risk Category	Employer Number	Category	Reason for Delay	Summary of Current Position	Action Plan	Target Completion Date
1 Year +	503	Delay in admission body providing information	Delays in admission body providing staffing list	HCC Legal liaising with employer to progress admission agreement & bond	Administering Authority to escalate lack of response from admission body with senior management of outsourcing employer.	Sep-17
1 Year +	504	Delay in admission body providing information	Delays in admission body providing staffing list	HCC Legal liaising with employer to progress admission agreement & bond	Administering Authority to escalate lack of response from admission body with senior management of outsourcing employer.	Sep-17
1 Year +	506	Delay in admission body providing information	Delays in admission body providing staffing list	Data with Hymans to calculate employer contribution rate/bond amount	Hymans calculation delayed due to backlog following triennial valuation. Admission process will proceed when received.	Sep-17
1 Year +	508	Delay in admission body providing information	Delays in admission body providing staffing list	Data with Hymans to calculate employer contribution rate/bond amount	Hymans calculation delayed due to backlog following triennial valuation. Admission process will proceed when received.	Sep-17
1 Year +	534	Delay in admission body providing information	Delays in admission body providing staffing list	Data with Hymans to calculate employer contribution rate/bond amount	Hymans calculation delayed due to backlog following triennial valuation. Admission process will proceed when received.	Sep-17
6-12 Months	465	Delay in admission body providing information	Delays in admission body providing staffing list	Data with Hymans to calculate employer contribution rate/bond amount	Hymans calculation delayed due to backlog following triennial valuation. Admission process will proceed when received.	Sep-17
1 Year +	493	Delay in admission body securing indemnity/querying form of indemnity	Delays in admission body securing bond	Awaiting confirmation of bond secured by employer	Admission agreement expected to be completed shortly – currently with admission bodies solicitors for final review	Aug-17
1 Year +	509	Delay in admission body securing indemnity/querying form	Delays in admission body securing bond	Awaiting confirmation that bond has been secured by employer	HCC Legal to escalate lack of response from admission body with senior management of outsourcing employer (HCC).	Sep-17

Risk Category	Employer Number	Category	Reason for Delay	Summary of Current Position	Action Plan	Target Completion Date
		of indemnity				
6-12 Months	518	Delay in admission body securing indemnity/querying form of indemnity	Amendments to staffing list provided by admission body, followed by queries from admission body on clauses of bond agreement	HCC Legal liaising with employer to progress admission agreement & bond	HCC Legal to monitor progress and escalate if required – currently waiting for final sign off from admission body	Aug-17
6-12 Months	528	Delay in admission body securing indemnity/querying form of indemnity	Ceding employer and admission body to agree bond value	Indemnity arrangements being agreed between ceding employer and admission body	Await decision from admission body/ceding employer - Administering Authority to escalate risks to ceding employer of no current indemnity	Aug-17

1 Year +	420	Dispute over conditions of admission	Dispute over conditions of admission	Awaiting legal opinion	Case information being collated to be passed to Squires for legal opinion in order to confirm HCC position and provide legal position on dispute.	TBC
1 Year +	437	Dispute over conditions of admission	Employee(s) incorrectly admitted by the admission body under an existing agreement, but for a separate service contract. Also query around who should act as ceding employer	Indemnity arrangements being agreed between ceding employer and admission body	Bond calculation sent to employer and has been challenged.	Sep-17
1 Year +	472	Dispute over conditions of admission	Employee(s) incorrectly admitted by the admission body under an existing agreement, but for a separate service contract	Employees incorrectly coded originally and now admission agreement to be completed for correct separate service contract	HCC to progress admission agreement by contacting admission body and ceding employer	Sep-17

Risk Category	Employer Number	Category	Reason for Delay	Summary of Current Position	Action Plan	Target Completion Date
1 Year +	452	Dispute over conditions of admission	Legal query on parties to be covered by admission agreement	Admission agreement agreed with employer and awaiting signed copy	Expected to be completed shortly, final version with parties for signing.	Jun-17
1 Year +	521	Dispute over conditions of admission	Employee(s) incorrectly admitted by the admission body under an existing agreement, but for a separate service contract	Data with Hymans to calculate employer contribution rate/bond amount	Hymans calculation delayed due to backlog following triennial valuation. Admission process will proceed when received.	Sep-17
1 Year +	500	Dispute over conditions of admission	Ceding employer did not acknowledge service contract/maintained no awareness of it	All active members have left	AA to be drafted in order for contributions to be collected.	July-17
6-12 Months	522	Dispute over conditions of admission	Contribution rate was queried and required to be re calculated by the Actuary	Employer have now agreed the contribution rate and happy to progress with admission agreement.	Details will be passed to HCC Legal in Jun-17 for the progression of Admission agreement	Aug-17
6-12 Months	527	Dispute over conditions of admission	Bond value higher than employer expected.	HCC have responded to all queries from the employer regarding the bond value and are awaiting a response.	Await response from employer and chase if necessary.	Sep-17
6-12 Months	532	Third Party Delays	Delays in the actuarial calculations due to a backlog following the 2016 Triennial Valuation	With HCC to calculate bond value before passing to Legal services to progress with Admission agreement	Details will be passed to HCC Legal in Jun-17 for the progression of Admission agreement	Aug=17
6-12 Months	536	Third Party Delays	Delays in the actuarial calculations due to a backlog following the 2016 Triennial Valuation	With HCC to calculate bond value before passing to Legal services to progress with Admission agreement	Details will be passed to HCC Legal in Jun-17 for the progression of Admission agreement	Aug=17

Risk Category	Employer Number	Category	Reason for Delay	Summary of Current Position	Action Plan	Target Completion Date
0-6 Months	533	N/A	N/A	With HCC to calculate bond value before passing to Legal services to progress with Admission agreement	Details will be passed to HCC Legal in Jun-17 for the progression of Admission agreement	Aug-17
0-6 Months	537	N/A	N/A	With HCC to calculate bond value before passing to Legal services to progress with Admission agreement	Details will be passed to HCC Legal in Jun-17 for the progression of Admission agreement	Aug-17
0-6 Months	535	N/A	N/A	Indemnity arrangements being agreed between ceding employer and admission body	Await decision from employer/ceding employer - Administering Authority to escalate risks to ceding employer of no current indemnity	Aug-17

Total: 23 Outstanding Agreements

Shared Internal Audit Service
Hertfordshire in Partnership

Final Internal Audit Report

Hertfordshire County Council – Pensions Administration

February 2017

Issued to:	Jolyon Adam – Finance Manager (Pensions, Treasury and Client Team) Patrick Towey – Head of Specialist Accounting Taryn Mutter – Pension Service Delivery Manager (LPP)
Copied to:	Claire Cook – Assistant Director of Finance
Report Status:	Final
Reference:	16940/16/001
Overall Assurance:	Substantial

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Section **Page**

1. EXECUTIVE SUMMARY

Introduction

1.1 Internal Audit provides the Council with an independent and objective opinion on the organisation's governance arrangements, encompassing internal control and risk management, by completing an annual risk-based audit plan. This audit formed part of the approved 2016-17 Annual Audit Plan.

1.2 Since 1 April 2011 the administration of the HCC Local Government Pension Scheme ("the LGPS") and the Fire Service scheme ("Fire Scheme") has been administered by the Local Pensions Partnership "LPP"), formerly London Pensions Fund Authority. The LPP acts as third party administrator for the schemes with the Council's Finance team retaining responsibility for the governance of the LGPS Scheme, the management of investments and the engagement with fund managers and the Council's HR team retaining responsibility for the governance of the Fire Scheme.

1.3 As at the end of the 2015/16 financial year, the LGPS Scheme had 95,995 members (comprising active contributing members, deferred members and pensioner members). The total value of the LGPS Scheme Fund shown in the Statement of Accounts at 31 March 2016 was over £3,584 million. The LPP also manage the Fire Service scheme, however, no funds are under management for the Fire Scheme.

1.4 The introduction of the Work Place Pensions Automatic enrolment requires the Council to enrol all employees aged 22 to state pension age and who earn more than £10,000 into a pension scheme unless the employee decides to opt out.

1.5 The objective of this audit was to provide management with assurance over the adequacy of the control environment for the processing of new joiners, leavers, transfers in/out, collection of contributions due and payment of pensions to those eligible.

Overall Audit Opinion

1.6 Based on the work performed during this audit, we can provide overall **Substantial Assurance** that there are effective controls in operation for those elements of the risk management processes covered by this review. These are detailed in the Assurance by Risk Area Table in section 2 below.

1.7 The overall audit opinion was formed from management assurances given in response to our enquiries and an examination of appropriate evidence relating to the administration, record keeping and payments within the pension scheme.

1.8 With respect of the administration for joiners, leavers, new pensioners and transfers in and out of the scheme, we found that all necessary records were in place and retained, required actions had been processed in a timely manner and all records and calculations were accurate, both from physical or online forms and through the Altair/SAP interface.

1.9 We have noted that contributions are received from Admitted Bodies on a monthly basis and records are retained by way of a database that is regularly reconciled to the records held in SAP.

1.10 Reconciliations are largely completed on a quarterly basis, with the exception of transfers in and out which is reconciled every six months. All reconciliations are completed by LPP and reviewed and approved by the accountancy team from HCC. In the case of the rate and adjustments (R&A) and payroll reconciliations it was noted that these can progress to the reconciliation sign-off stage, where any unexplained variances are considered insignificant. A materiality level has been agreed for such purposes for the R&A reconciliation, with the payroll reconciliation instead relying on officer judgement. Despite a tolerance level being set, LPP are still required to review and clear all variances in advance of year end.

1.11 From the sample of new pensioners tested, we found that in all cases the calculations were accurate and were subject to a second officer review for both the annual value of the pension, any commuted amounts and also the monthly payroll amounts prior to finalisation.

1.12 The pay run for pensioners was tested and we confirmed that exception reports are run and review for new pensioners, material payments and leavers within the period. Our testing confirmed that there has been sufficient separation of duties in the payroll process with two officers involved throughout. Prior to the BACS run being completed, checks are performed to confirm that the number and value of payments are as expected.

1.13 Finally, we have completed a review of the system access for Altair and following this access levels for four officers has been revised to improve the segregation of duties between the administration and payroll elements of the system. There are now only five user profiles with full system access, two of which belong to the external system developers, and the remaining three deemed as necessary for system administration purposes.

1.14 For definitions of our assurance levels, please see Appendix B.

Summary of Recommendations

1.15 We have made two recommendations, both classified as ‘Merits Attention’, to further strengthen the internal controls.

1.16 Please see Management Action Plan at Appendix A for further detail.

Annual Governance Statement

1.17 This report provides good levels of assurance to support the Annual Governance Statement.

2. ASSURANCE BY RISK AREA

2.1 Our specific objectives in undertaking this work, as per the Terms of Reference, were to provide the Council with assurance on the adequacy and effectiveness of internal controls, processes and records in place to mitigate risks in the following areas:

Risk Area	None	Limited	Moderate	Substantial	Full
System Checks for Scheme Joiners, Leavers, Change of Circumstance – appropriate controls are in place to ensure that starters, leavers and change of circumstances are processed in a timely and accurate manner.					
Pension Records and Contributions – Pension records adequately reflect a member's active service and contributions due from members (including admitted bodies and third parties) are received and accounted for in full.					
Pensions Payroll New Starters – appropriate controls are in place to ensure that new starters to the pensions payroll are appropriately authorised, eligible, benefits are correctly calculated and appropriate validation checks performed.					
System Interface Checks - interface file checks are in place between all key systems to ensure that data transferred is complete and accurate.					
Pension Payments Payroll Validation – appropriate validation and reconciliation routines are in place to confirm that the pension's payroll is accurate and complete, prior to submission for payment.					
Reconciliations – agreed reconciliations are carried out on a timely basis, with exceptions being investigated and resolved.					
Annual Benefit Statement – assess the progress in delivering the agreed actions within the improvement action plan submitted to the Pensions Regulator.					

Transfers in / out – requests for transfers in and out the scheme are administered on a timely and accurate basis. All payments are appropriately authorised and paid to the correct beneficiary and transfers in are received in full, correctly accounted for and members records are accurately updated.					
Systems Access - Access to key systems and modules are appropriately controlled and access to specific responsibility groups is aligned to an individual's role and business need. Access granted maintains an appropriate segregation of duties and is end-dated promptly when no longer required.					

Overall					

2.2 See definitions for the above assurance levels at Appendix B.

No.	Finding / Associated Risk	Priority	Recommendation	Management Response	Target Date
1.	**Reconciliations – Payroll Unexplained Variances** Discussions with the Senior Accountant revealed that a tolerance level has not been set for unexplained variances resulting from the payroll reconciliation completed quarterly. Where there is an unexplained variance within the payroll reconciliation the accountancy officers (HCC) will make a judgement if the variance is acceptable. This is different to the approach to the quarterly rates and adjustment reconciliation, where the Council have agreed a tolerance level above which reconciliations cannot be submitted for approval until the unexplained variance has been investigated and cleared. <u>Associated Risk</u> By using a subjective approach to the acceptability of variances, there may be an inconsistent approach to investigating the variances. This may	Merits Attention	We recommend that, in order to remove the subjectivity of acceptable variances, the Council agree a tolerance level to be applied against the payroll reconciliations. A tolerance level should be set with both a monetary value (e.g. £1,000) and a percentage of the total payroll for each Admitted Body (e.g. 1%). Whilst making this recommendation, the aim should always be to identify and rectify any variances discovered in a timely manner.	Management will look to implement an appropriate tolerance level for variances which require investigation prior to approval. **Responsible Officer:** Senior Accountant (Pensions), Finance Manager (Pensions, Treasury, Banking and Taxation Team) – whilst position is recruited to.	31 May 2017

No.	Finding / Associated Risk	Priority	Recommendation	Management Response	Target Date
	result in increased officer time, and increase the risk of fraud and error not being identified and subsequent financial loss to the Council.				
2.	**Joiner Forms and Input** Based on the compliance testing performed, we have been able to conclude that data input for new joiners was accurate and complete. However, in terms of system design, there are currently no in-built system validation checks to prevent errors or omissions at the data input stage. We have noted there any errors or omissions in data input would be identified and rectify during the year end interface upload for all admitted bodies. <u>Associated Opportunity</u> Identification of errors and omissions in data may be identified and corrected earlier saving officer time at year end.	Merits Attention	We recommend that management examine the Altair functionality to determine whether mandatory fields could introduced for key data required for new joiners (e.g. National Insurance number, name, address, salary and contribution rates). This will improve the preventative controls in place to reduce the risk of errors at the data input stage. In addition to the above, sample management checks on data input could also be considered to identify other error types such as transposition errors.	LPP will be requested to raise the request for this change to the Altair system at the next ‘Class Group’, where it will be considered by the application’s users, and - if agreed as an appropriate amendment – prioritised and added to a development list. Depending on the outcome of the proposal above, the second element of the recommendation will be considered, although LPP consider that their current approach of identifying and correcting any errors at year end is sufficient. **Responsible Officer:** Finance Manager (Pensions, Treasury, Banking and Taxation Team)	31 March 2017

Levels of assurance	
Full Assurance	There is a sound system of control designed to achieve the system objectives and manage the risks to achieving those objectives. No weaknesses have been identified.
Substantial Assurance	Whilst there is a largely sound system of control, there are some minor weaknesses, which may put a limited number of the system objectives at risk.
Moderate Assurance	Whilst there is basically a sound system of control, there are some areas of weakness, which may put some of the system objectives at risk.
Limited Assurance	There are significant weaknesses in key control areas, which put the system objectives at risk.
No Assurance	Control is weak, leaving the system open to material error or abuse.

Priority of recommendations	
High	There is a fundamental weakness, which presents material risk to the objectives and requires urgent attention by management.
Medium	There is a significant weakness, whose impact or frequency presents a risk which needs to be addressed by management.
Merits Attention	There is no significant weakness, but the finding merits attention by management.

HERTFORDSHIRE COUNTY COUNCIL

PENSIONS COMMITTEE

TUESDAY, 27 JUNE 2017 AT 11:30AM

Agenda Item No:
4

PENSION FUND ASSET POOLING – ACCESS UPDATE

Report of the Director of Resources

Author of the report: Patrick Towey, Head of Specialist Accounting
(Telephone: 01992 555148)

1. Purpose of the Report

1.1 To provide the Pension Committee with a review of the activities undertaken by the ACCESS group since the last update that was shared with this Committee in February 2017.

2. Summary

2.1 At its meeting on 7 March 2017, the Pension Committee recommended to Council that the Council agrees to set up a Joint Governance Committee (JGC) with the other ten member authorities of the ACCESS pool with effect from the date of completion of the Inter Authority Agreement (IAA) and to appoint one member of the Council to the Joint Governance Committee. Council approved this recommendation at its meeting of 21 March 2017. All eleven ACCESS member Councils have now agreed the IAA and the creation of the JGC.

2.2 The ACCESS group in its July 2016 submission to Government set out its intention to rent a Financial Conduct Authority (FCA) approved operator for the future management of the Fund assets of the ACCESS pool. The Government approved this submission on 22 March 2017. Each pool is expected to have its pool structure in operation by the 1st April 2018.

2.3 ACCESS will procure an operator thorough an open public tender procurement process, this work is being led by Kent County Council procurement team supported by officers from the other ACCESS Funds. Squire Patton Boggs has been appointed as legal advisor to the Pool following a procurement led by Hertfordshire officers. Hymans Robertson is acting as the project manager for the ACCESS group and has supported this project since their appointment in early 2016.

2.4 The ACCESS submission to Government in July 2016 set out an intention for a “quick win” from consolidating passive mandates. Consolidation of these mandates with one market provider will deliver savings from reduced fees as a result of the size of assets under management. A provider will be appointed from the National LGPS frameworks procurement vehicle for the ACCESS pool. The Hertfordshire Fund currently has £1.37bn assets under passive management with Legal & General Investment Management.

3. Recommendations

3.1 That the Pensions Committee notes the content of this report.

4. Background

4.1 In the summer 2015 budget the Chancellor announced the Government's intention to invite Administering Authorities to make proposals for pooling LGPS investments. The Department for Communities and Local Government (DCLG) published its criteria for pooling investments in November 2015 based on four elements:

1. Scale – Pools of assets with at least £25bn of assets;
2. Strong Governance – authorities are charged with defining the mechanisms by which they can hold the pool to account;
3. Reduced costs – including estimated savings over the next 15 years; and
4. Improved capacity to invest in infrastructure through pooling.

4.2 The Hertfordshire LGPS is a member of the ACCESS pool which is made up of eleven Shire Counties from the East, South East, and South of England. In its July 2016 submission to Government, ACCESS set out its plan to pool investments through a Collective Investment Vehicle (CIV) that would be administered and maintained by a third party operator. The operator would be collectively managed by the pension funds through a joint governance committee established by the Authorities and made up of one member from each authority.

4.3 The role of the operator is to manage collectively the assets of the ACCESS pool. The operator does this by setting up a collective investment scheme (CIS) which is a regulated vehicle under the Financial Securities and Markets Act 2000 ("FSMA"). Establishing or operating a CIS is a regulated activity requiring authorisation from the Financial Conduct Authority ("FCA").The participants in the scheme i.e. the ACCESS Funds will share the profits or income in the sub- funds in which they are invested in through the CIS. However, the ACCESS funds will not have day-to-day control over the management of the assets; this will be the responsibility of the Operator as this is a regulated activity.

5. Governance

5.1 The inter-authority agreement will establish the Joint Governance Committee (JGC); the JGC will be responsible for the following functions:

- Specifying the operator service to be procured;

- Procuring the operator;
- Appointing the operator;
- Reviewing the performance of the operator;
- Managing the operator; and
- Appointment of advisers.

5.2 The JGC will be "hosted" by one of the ACCESS local authorities and will undertake the secretariat function for the JGC. Kent County Council will be the initial host authority. The Chairmen of the ACCESS Pension Fund Committees have up to this point in time met on a shadow basis and will formally meet for the first time as an established body in July 2017, subject to the completion of the legal sealing of the IAA by all Funds. At this first meeting, a Chairman and Vice-Chairman will be appointed by the eleven ACCESS fund Chairmen.

5.3 In its shadow form the ACCESS Chairmen have met monthly supported by Fund officers, these meetings have been chaired by a Hertfordshire Officer, Patrick Towey. The Hertfordshire Pension Committee (PC) and Pension Board have been kept appraised of the ACCESS pool development and progress at its quarterly meetings.

5.3 The Pension Committee's future role will be to agree and approve the investment strategy for the Fund. However, the PC will no longer be able to appoint Fund managers directly and in the future this role will be undertaken by the Operator who will appoint the managers in consultation with the JGC. The asset allocation requirements of each Fund will be implemented by the JGC who will instruct the Operator via a client function, made up of Fund officers, to set up sub funds to meet the Funds' requirements. The Chairman of the Hertfordshire Pension Fund will sit on the JGC alongside the other ten Chairmen of the ACCESS Funds.

6. Procurement

6.1 Kent County Council's procurement team are leading on the procurement of the Operator supported by a number of ACCESS officers and Hymans specialists. Squire Patton Boggs have been appointed to provide legal advice to ACCESS and are supporting officers in the drafting of tender and contract documents as well as providing advice on FCA regulations and procurement law.

6.2 To inform the procurement approach to be adopted a concept viability day was held in April attended by ACCESS Fund Chairmen at which a number of operator providers also attended. The purpose of this meeting was to gain a better understanding of market coverage and experience and to inform certain gaps in the tender specification. Following this meeting the ACCESS Chairmen agreed that an open procurement process should be adopted as opposed to a competitive dialogue which is only used for complex procurements where the requirement is not fully known.

6.3 The proposed procurement timetable is set out below:

Stage	Dates
Issue OJEU[1] & ITT[2]	10 July 2017
Tender response deadline	21 August 2017
Tender evaluation period	22 August - 22 September 2017
Governance	25 September - 13 October 2017
Notification of award, pre-award meeting & contract construct	16 October – 31 October 2017
Contract signature	1 November 2017

6.4 The contract term will be for five years with the option to extend for a further two years. The expectation is that the appointed Operator will be able to get an FCA Authorised Contractual Scheme (ACS) umbrella structure established by the 1st April although transition of assets to the pool may not occur immediately.

6.5 In order to (a) reduce transition costs on the initial transfer of assets from individual administering funds into the ACCESS ACS and (b) retain a number of existing investment managers, it is anticipated that some or all of the initial set of ACS sub-funds will use investment managers currently contracted to ACCESS administering authority Funds.

A detailed analysis of the areas of commonality between the existing investment managers and mandates will need to be undertaken. This will include an analysis of benchmarks for various asset classes and will inform for consideration by the JGC the initial set of ACS sub-funds. A sub-fund will be created for each asset class and could be single or multi-manger depending on the requirements of the ACCESS funds.

This analysis will be commissioned from a third party and will be undertaken alongside the Operator procurement so that on contract award the appointed Operator will have a framework structure of sub-funds to set up. For the purpose of submitting tender bids, tenderers will be asked to submit bids based on two model portfolios with an estimated range of between 25 to 35 sub-funds.

7. Passive Procurement

7.1 The ACCESS pooling proposal submitted to Government in July last year set out an intention for a “quick win” from consolidating passive mandates with one single asset manager. Passive mandates are held in the form of a Life Policy between the administering authority and the appointed external investment manager and can’t be pooled under an ACS structure. The total assets under passive management for ACCESS are £10.5bn

[1] OJEU – Official Journal of the European Union
[2] ITT – Invitation to tender

7.2 ACCESS, working through the National LGPS Frameworks procurement vehicle has completed the construct of a multi-provider framework. Contracts were awarded to four passive providers in January 2017:

- Legal & General Investment Management Limited
- Deutsche Asset Management (UK) Limited
- BlackRock Investment Management (UK) Limited
- UBS Asset Management (UK) Limited

7.3 The passive framework documentation provides useful information such as ceiling fee prices from the four providers which can be applied against the pool's current arrangements. This information indicates:

- That all funds which currently hold passive mandates will makes savings against any of the four providers on the framework; and
- The July ACCESS submission estimated a pool level savings target of £4m per annum and is a reasonable expectation of the outcome of a "mini" tender process.

7.4 ACCESS has now commenced a "mini" tender process within this framework. The procurement process is due to conclude in June/July and the intention is to appoint a single provider to the ACCESS pool. A recommendation will be put to the JGC for ratification at either its July or August meeting.

7.5 Once the outcome of the tender is known, an analysis will be undertaken by officers to compare current provider fee arrangements to the successful bidder and if there are demonstrable savings and a clear value for money case then a recommendation will be made to this Committee to appoint the manager awarded the ACCESS passive contract.

8. Financial Implications

8.1 The costs incurred by the Hertfordshire Fund up to the end of March 2017 were £103,897.44 for the ACCESS project; these costs include legal and project management fees but exclude officer time. The estimated implementation costs of establishing a CIV are estimated to be £160k for the Hertfordshire Fund.

8.2 Eventual savings for the ACCESS Pool are projected to be £30m annually. Allowing for investment growth of 3-5% per annum, by year 10 this will be [3]equivalent to £40-50m.

Background Information:

ACCESS July submission to Government (http://cmis.hertfordshire.gov.uk/hertfordshire/Calendarofcouncilmeetings/tabid/70/ctl/ViewMeetingPublic/mid/397/Meeting/617/Committee/11/Default.aspx)

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[3] ACCESS pool submission to Government dated 15th July 2016.

HERTFORDSHIRE COUNTY COUNCIL

Agenda Item No.

5

PENSIONS COMMITTEE
TUESDAY, 27 JUNE 2017 AT 11:30AM

REVIEW OF VOTING POLICY AND IMPLEMENTATION

Author: Nick Sykes, Mercer

MERCER
MAKE TOMORROW, TODAY

REVIEW OF VOTING POLICY AND IMPLEMENTATION
HERTFORDSHIRE COUNTY COUNCIL PENSION FUND ('THE FUND')

INTRODUCTION AND CURRENT APPROACH

Asset owners, such as the Fund, have a responsibility to hold to account the management of companies in which they invest. For listed companies, one way in which this can be done directly is through the exercise of voting rights attached to the shares owned by voting on all resolutions posted at Annual and Extraordinary General Meetings, where practicable.

Whilst this sounds simple, in practice there are a number of steps in the process and various parties involved. The current approach adopted by the Fund is as follows:

- All management of listed equities is delegated to a number of third party asset managers who are responsible for the decisions to buy and sell shares in companies (and in many cases meeting companies and establishing a relationship with company management as well as ongoing engagement with company management).

- For equities held in segregated mandates, the shares are directly owned by the Fund and are held in custody by the Fund's custodian, Bank of New York Mellon. The Fund's custodian is responsible for managing the operational aspects of the Fund's investments including actually exercising the votes of shares held and, before that stage, receiving shareholder information about AGM and EGM resolutions and passing this on to ISS (Institutional Shareholder Services), a third-party proxy voting advisor.

- For pooled fund holdings, the shares are voted in-line with the voting policy of the investment manager of the pooled fund (e.g. LGIM exercises the votes in respect of the Fund's pooled fund index equity holdings).

- ISS has been appointed by the Fund to provide voting recommendations (typically 'For', 'Against' or 'Abstain') for the Fund's direct shareholdings... The Fund's custodian provides ISS with information on the Fund's holdings as well as identifying the resolutions that are to be voted upon. ISS gathers company information, undertakes research, and has developed its own voting policies, taking account of international standards on corporate governance and stewardship. ISS applies its voting policies to the shareholdings to determine a voting recommendation for each resolution. The recommendation of ISS can be overridden either by the manager in whose portfolio the shares are held or by the asset owner client (the Fund) should there be a particular issue on which the Fund had an explicit direction in which it wanted its votes to be cast (for example, if it was partaking in a collective engagement with other asset owners). ISS then instructs the Fund's custodian to exercise the votes as per the resulting recommendation.

PROS AND CONS OF THE CURRENT APPROACH

The advantages of the current approach are:

- By delegating the decisions on voting the Fund's direct shareholdings to ISS, the Fund removes the need for the Fund's Officers or the Pensions Committee to get involved in either establishing a voting policy (e.g. in terms of board composition) or executing that voting policy through ensuring that all votes are cast at all Company meetings, which is resource intensive.

- There is generally consistency of voting across all the Fund's direct shareholdings (albeit subject to the managers having the ability to override the recommendation of ISS). If more than one manager owns the same shares (and assuming managers don't exercise their right of veto in respect of ISS's voting recommendation) the Fund will vote in a same way across its whole direct shareholding. ISS's policies are also designed to be consistently applied across the full range of the Fund's shareholdings and over time.

- ISS spends time and effort on formulating its policies on voting and on individual voting issues; there should therefore be a clear reason why votes are cast in a particular way.

There are also some disadvantages to the current approach:

- In choosing to delegate its voting activities to a third-party proxy voting provider, ISS, the Fund's Officers or the Pensions Committee need to monitor and periodically review the voting policies of ISS to ensure the service is in-line with expectations.

- By outsourcing the voting to ISS, there is a separation of the voting decision from the buy/sell decision. It also detaches the voting decision from the managers who are likely to have a relationship with the management of companies in which they invest and therefore could result in the voting recommendation being detached from ongoing engagement by the investment manager with company management.

- ISS is not in a position to undertake any engagement with company management, which can lead to conflicting approaches between the manager and ISS with respect to voting recommendations.

- ISS may not have the required expertise to fully assess more specialist resolutions (e.g. on particular environmental or social issues) or resolutions for companies that are less 'well-known'.

- ISS's policies are likely to be consistently applied but are generally 'broad brush' following standard corporate governance codes, which may leave with little room for appropriate exceptions or specific circumstances.

- There is a cost to the Fund involved in subscribing to ISS's service.

  Overall, therefore, the current approach aims to ensure that the shares that the Fund owns are voted, with a consistent policy approach directing the votes. This is, however, likely to be a fairly broad brush, 'one size fits all' policy approach.

THE ALTERNATIVE APPROACH TO VOTING

The alternative to using ISS would be to leave the responsibility for voting the Fund's direct shares with the managers who own these shares in their portfolio. The advantages of this would be:

- There would be a consistency of approach from the manager's perspective and also from the investee company's. If there was an issue (of say board composition) it would be expected that the manager would raise this in its discussions with management and only if there was a clear failure to address an issue would it be expected that the manager voted against company AGM resolutions.

- Votes may well therefore have more 'robustness' about them, given greater alignment with ongoing engagement activity, rather than a blanket application of a general policy.

- The managers would not be expected to charge for the service of voting the shares they own and would be expected to report on any key issues (in fact as they do at the moment, whereas the Pensions Committee does not receive reports setting out explanations directly from ISS).

Potential disadvantages of this approach would be:

- There could be a lack of consistency in terms of voting across the Fund's shareholdings as managers could vote in different ways on the same company resolutions. However, this in itself is not necessarily an issue should each manager be able to clearly articulate its reasons for voting in a particular way (e.g. this may depend on the length of time a manager has owned the shares or how long the manager has been engaging with a company on a particular issue).

- Managers may not be as focussed on ensuring that all votes are cast on all possible occasions, whereas ISS has a specific mandate to ensure this happens. In practice managers are these days generally pretty effective at implementing voting across their shareholdings (this was not the case in the past) and expectations on the approach to voting and engagement can be included in the Investment Management Agreements (IMAs) to ensure managers vote on all resolutions, where practicable.

Under this approach, while neither an explicit advantage nor disadvantage, if the Fund was to give responsibility for voting to the managers, it would be appropriate for the Fund's Officers or the Pensions Committee to review the managers' corporate governance policies from time to time and to monitor their compliance with the UK Stewardship Code or other yardsticks of best practice that may be developed in the years ahead.

CONCLUSION AND RECOMMENDATIONS

There was a time when asset managers had the reputation for being "sleeping partners" due to their failure to vote the shares they owned on behalf of clients and, in doing so, failing to hold company managements to account. This is generally no longer the case and the Fund's equity managers are expected to adopt both robust corporate governance and comprehensive voting policies.

We would recommend that that voting is no longer outsourced to ISS but is made the responsibility of the investment managers instead:

- Our view is that interests are typically more aligned when the voting rights attached to shares are managed by the same entity that is responsible for the buy/sell decision.

- Investment managers are generally better placed (relative to third-party proxy voting providers) to identify and engage with company management on strategic issues as well as Environmental, Social and Corporate Governance (ESG) issues, The exercise of voting rights is typically aligned with such engagement activity.

Prior to implementing this change, we suggest that the Pensions Committee reviews the managers' voting policies and track record to ensure that best practice is being implemented e.g. in comparison with the provisions of the UK Stewardship Code. We recommend that the Pensions Committee continue to review these policies, including that of LGIM, on a periodic basis.

We believe that this will result in company management being held to account more effectively by the asset managers, whose investment performance depends in part on robust scrutiny of the companies they own, with the aim of seeing value created by management.

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Nick Sykes
June 2017

HERTFORDSHIRE COUNTY COUNCIL

Agenda Item No.

6

PENSIONS COMMITTEE
TUESDAY, 27 JUNE 2017 AT 11:30AM

INVESTMENT STRATEGY

Author: Nick Sykes & Catrina Arbuckle, Mercer

INVESTMENT STRATEGY

HERTFORDSHIRE COUNTY COUNCIL PENSION FUND ("THE FUND")

JUNE 2017

Nick Sykes & Catrina Arbuckle

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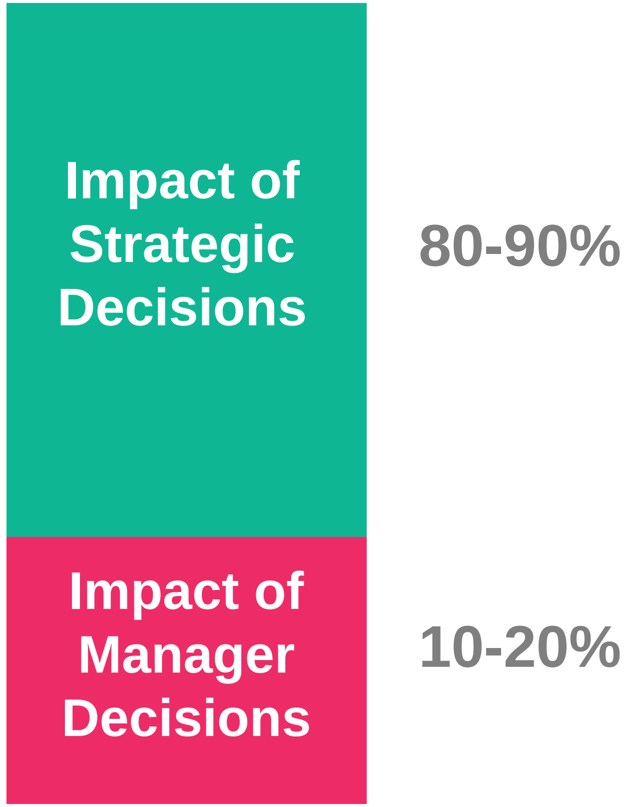
INVESTMENT STRATEGY

WHAT DO WE MEAN BY 'INVESTMENT STRATEGY'?

INVESTMENT STRATEGY
WHAT DO WE MEAN BY "INVESTMENT STRATEGY"?

- Long term allocation between various asset classes, such as equities, bonds, property etc.
- Most important decision for most pension funds
  - Returns between asset classes can vary significantly
  - Whereas manager returns for the same asset class tend to be within a few percentage points
- The investment strategy should consider the Fund's specific liabilities and investment objectives

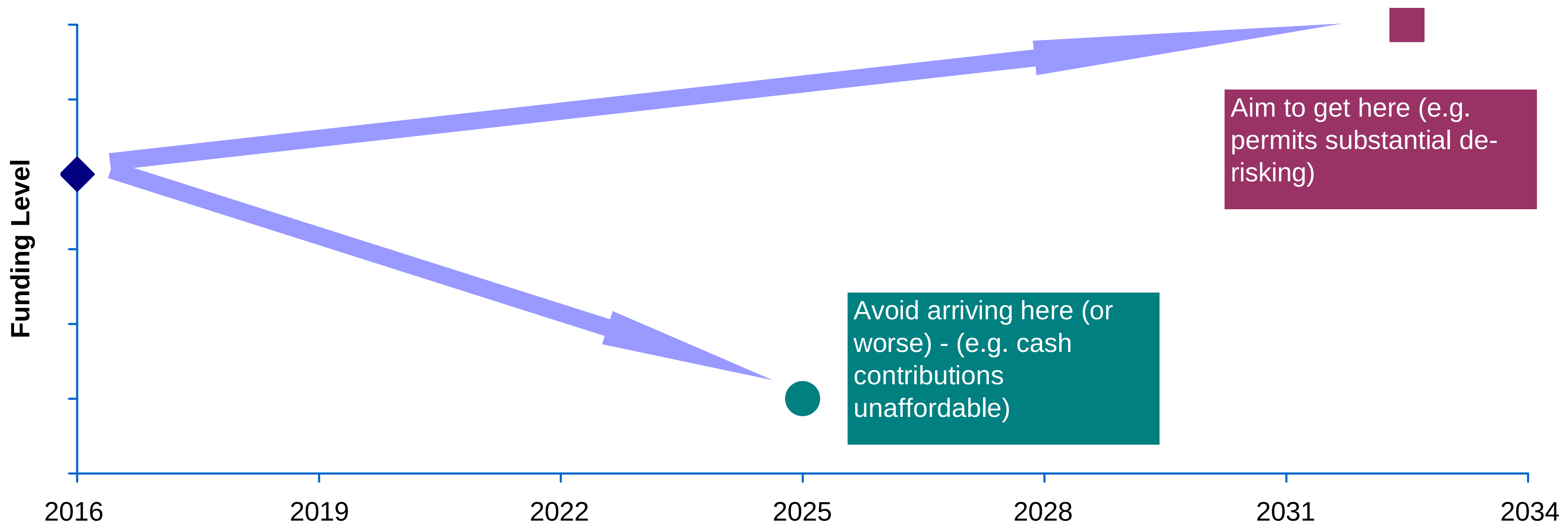
TYPICAL EXPECTATION



Investment strategy contributes the majority of investment performance and – just as importantly – investment risk

INVESTMENT RISK AND INVESTMENT STRATEGY
WHERE DO WE WANT TO BE?

- Main driver of investment risk is investment strategy
  - Broad long term allocations to the major asset classes (equities, bonds, alternatives, etc)
- Aim of taking investment risk is to (in conjunction with contributions):



- Once you have identified an objective and an acceptable level of risk which will meet that objective, create an investment strategy that seeks to achieve the greatest expected return for that risk level.

INVESTMENT STRATEGY
WHAT IS DESIRABLE FOR THE FUND?

DESIRABLE CHARACTERISTICS…

INFLATION LINKED	• The majority of benefit payments are linked to inflation. It therefore makes sense to have a significant allocation to assets where returns have either an implicit or explicit link to inflation.
REFLECT BELIEFS	• The investment strategy should reflect the beliefs of the Fund. For example: Illiquid assets (to harvest ‘illiquidity premium’) and risk mitigation where possible.
CASHFLOW GENERATING	• The Fund should have a mind to meeting benefits without becoming forced sellers of assets. Investments that generate secure income can help to address this need. This will become more important over time.
RETURN GENERATIVE	• There is a deficit for the Fund to recover over time. Therefore, unless an investment is specifically required for risk management purposes, there should be a clear focus on long term return potential of the assets to help reduce the deficit over time.

INVESTMENT STRATEGY

PLAN FOR THE FUTURE

INVESTMENT STRATEGY
2016 TRIENNIAL VALUATION RESULTS

- Hymans have produced the 2016 triennial valuation results for the Fund, which shows that over the three year period from the 31 March 2013 the Funding level has increased by 9%, from 82% in 2013 to 91% in 2016.
- But how does this compare to what we would have expected in 2010?

	31 March 2010	31 March 2013	31 March 2016
Expected funding level of 65/35 strategy*	-	79%	84%
Actual Funding level	74%	82%	91%

* Funding level based on a 50% probability in the 2010 ALM analysis

- The Fund is materially ahead of where it was expected to be as at the 2016 valuation (as it was, to a lesser extent, at the 2013 valuation).
- This is to be expected though as the Fund has not completely implemented the move to 65/35, and is currently at 75/25.
- Given the higher level of risk that the Fund is taking you would expect the Funding level to be higher (although, in practice, this is not the main driver).

INVESTMENT STRATEGY
WHY ARE WE AHEAD OF SCHEDULE?

Positive Contributing Factors

- **Strong Investment Returns** – Fund returned 6.9% p.a. over the three years to 31 March 2016, these were above those assumed by the actuary
- **Reduction in Inflation Expectation** – the Fund's inflation assumptions have changed from the 2013 valuation, the assumed wedge between CPI and RPI has increased by 0.2%, Salary increase has also changed from 0.5% above RPI to 0.9% below RPI. Overall 1.6% reduction in inflation assumptions
- **Membership experience over the period**
- Slight change in **liability discount rate**

Negative Contributing Factors

- **Reduction in Bond Yields** – given the valuation basis all else being equal a reduction in gilt yields increases the present value of liabilities
- **Interest on the deficit** – the deficit grows by the unwinding of the discount rate

INVESTMENT STRATEGY
OPPORTUNITY TO DE-RISK?

- Based on the analysis conducted so far there appears to be an opportunity to reduce the level of risk that the Fund is running.
- The question now is what is the most efficient way to reduce risk.
- There are clearly drawbacks to the traditional approach of buying risk-free assets like gilts given the unappealing yields on offer.
- Given this, it was agreed we should also consider alternative assets that would reduce the level of risk being run in equities and are expected to produce returns in excess of inflation, a “real asset portfolio”.
- It was agreed that an appropriate long term time frame would once again be to look over the next 21 years, 7 valuation cycles
- In addition to reviewing the current strategy and the previously agreed target of 65/35 growth/matching split we looked at two further strawmen to aid in the discussion
- The first strawman is again moving 10% out of equities, into a portfolio of “real” assets comprised of property (high lease value and private rented sector) and infrastructure debt
- The second strawman goes further with a 20% reduction from growth assets with the strategy both increasing the allocation to index-linked gilts introducing an allocation to real assets.

INVESTMENT STRATEGY
STRAWMEN SUMMARY

Asset Class	Current Allocation (25%/75%)	Target Allocation (35%/65%) bonds	Target Allocation (35%/65%) Real assets	Target Allocation (45%/55%) Real assets
UK Equity	16.0	10.0	10.0	5.0
Global Equity	34.2	30.0	30.0	25.0
Bonds	25.0	35.0	25.0	35.0
Property	8.0	8.0	8.0	8.0
HLV, Infrastructure Debt, PRS	-	-	10.0	10.0
Alternatives	10.8	11.0	11.0	11.0
Private Equity	5.0	5.0	5.0	5.0
Residual Assets/Cash	1.0	1.0	1.0	1.0
Total	**100.0**	**100.0**	**100.0**	**100.0**
Expected Return above gilts	3.5%	3.1%	3.3%	2.8%
1 Year Value at Risk	£830m	£740m	£760m	£670m

- All of the allocations above, should be able to support the current valuation assumptions
- But what effect does it have on the time probability of being fully funded in 2037 and the downside risk?

INVESTMENT STRATEGY
FUNDING LEVEL PROJECTIONS SUMMARY

Objective	Current	35%/65% Bonds	35%/65% Real	45%/55%
Return, 100% funded probability by 2037	65%	63%	66%	63%
Time until fully funded	c.5 yrs	c.6.5 yrs	c.6 yrs	c.7 yrs
Median expected funding level in 2019	96.1%	95.4%	95.9%	95.2%
Risk, 1 in 10 funding level in 2019	73.7%	75.7%	75.4%	77.4%

- All of the strategies, under the current prudent modelling, don't appear to meet the same probability likelihoods as the analysis for the 2010 valuation, in terms of long term funding level
- They do however all have a good chance of meeting long term objectives and reducing shorter term risks
- Of the 'strawman' portfolios consider, the Working Group's preference was for the portfolio with 65% in growth assets, of which 10% would be in real assets and 35% in bonds (as is currently targeted).

INVESTMENT STRATEGY

IMPLEMENTATION – FIRST STEPS

IMPLEMENTATION
TRANSITION PLAN

Asset Class	Current Allocation (25/75)	Target Allocation (35/65) Real assets	Change
UK Equity	16.0	10.0	**- 6.0**
Global Equity	34.2	30.0	**- 4.2**
Bonds	25.0	25.0	0.0
Property	8.0	8.0	0.0
HLV, Infrastructure Debt, PRS	-	10.0	+10.0
Alternatives	10.8	11.0	+ 0.2
Private Equity	5.0	5.0	0.0
Residual Assets/Cash	1.0	1.0	0.0
Total	**100.0**	**100.0**	**100.0**

- The key transition is from equities to the ‘Real Portfolio’ of assets although the Fund also needs to make new Private Equity commitments as the current holdings are running off.
- The real assets being considered are not asset classes which are quick to access and hence fast progress is unlikely.
- Key questions are nevertheless how to implement the real assets efficiently and which equity managers should we reduce to fund the new allocations in due course.

IMPLEMENTATION
BUILDING A PORTFOLIO OF REAL ASSETS

- Potential assets for inclusion in a real portfolio
  - Index Linked Gilts
  - Conventional Property
  - **HLV (High Lease to Value) Property**
  - **PRS (Private Residential Sector) Property**
  - Ground Leases
  - **Infrastructure Debt**
  - Infrastructure Equity
  - Agriculture
  - Timber
- All of the above have direct or strong links to inflation and could be considered as part of a real portfolio, however some don't offer an attractive opportunity at present or are impractical to invest in before pooling. We have therefore proposed investing in the three asset classes in bold.

IMPLEMENTATION
CONSTRUCTING THE REAL ASSET PORTFOLIO

Asset Class	Implementation options
High Lease to Value 'HLV' Property	• CBRE are the Fund's property manager, the Fund could have discussions with CBRE to establish an HLV allocation • Alternatively L&G (one of the Fund's current managers) along with other managers have highly rated funds.
Private Rented Sector 'PRS' Property	• CBRE are the Fund's property manager, the Fund could have discussions with CBRE about establishing a PRS allocation. • Alternatively L&G have a highly rated fund and other ACCESS members have recently allocated to other PRS managers which Mercer also rate highly.
Infrastructure Debt	• New managers would need to be appointed, and assets allocated. • Other ACCESS members have allocated to Infrastructure Debt managers so the Fund would not be acting alone.

IMPLEMENTATION
CONSTRUCTING THE REAL ASSET PORTFOLIO

- The easiest route would be to discuss with CBRE options to expand the property mandate with them. CBRE could be tasked with establishing a portfolio that would aim to invest in HLV & PRS that would target the desired return above inflation that the Fund requires.
  - We accordingly recommend setting up a call or meeting between officers, CBRE and Mercer as soon as possible to begin discussions.
- On account of LGIM's pooled HLV fund being highly rated by Mercer we also recommend that they are invited to a future meeting to provide training on this asset class and an overview of their fund and capabilities.
- Depending on the outcome of discussions with CBRE we would recommend engaging with the pooled PRS managers being used by other ACCESS members with a view to considering their appointment.
- The Fund could also, fairly easily, agree commitments with Infrastructure Debt managers that other ACCESS members have recently allocated following appropriate training on the asset class.
- We note however that in all cases, the Fund would need to complete due diligence on these opportunities before committing.

IMPLEMENTATION
REDUCING THE EQUITY PORTFOLIO

Manager	Asset Class	Current Allocation	Current Benchmark	Over/ underweight	Future Benchmark	Overweight
Baillie Gifford	UK Equity	9.5	10.0	-0.5	10.0	7.6
Jupiter	UK Equity	8.1	6.0	+2.1		
Allianz	Global Equity	11.2	10.0	+1.2	30.0	6.7
Baillie Gifford	Global Equity	4.6	4.0	+0.6		
LGIM	Global Equity	20.9	20.2	+0.7		

In practice LGIM allocation allowed to drift, the above assumes 16% allocation to UK equities in LGIM mandate

- Does the Committee have a preference for any of the above managers to be reduced more than any other? Do we continue to have a preference for Baillie Gifford over Jupiter for UK equities? Do we have a preference for Allianz over Baillie Gifford's LTGG (a new mandate for the Fund).
- We note rebalancing Jupiter’s 2.1% overweight position alone would provide c.£85m to begin building the real asset portfolio.
- Or do we have a preference for active management over passive management and so would prefer to reduce the LGIM holdings?
- As a side note, the LGIM global equity allocation has some exposure to UK equities, and the composition of the passive mandate should be reviewed.

IMPLEMENTATION PROPOSAL

- Now that the overall investment strategy has been agreed the composition of each asset class needs to be discussed and agreed upon, no easy task.
- We recommend that Fund's officers and the Committee initially focus on which managers should be appointed to manage the HLV property, PRS property and infrastructure debt allocations in the real asset portfolio as these mandates will take some time to establish in view of the nature of the asset classes
- To start building the Real Assets portfolio c.£85m could immediately be allocated to property from Jupiter as an initial source of assets.
- We also recommend that the Committee delegates responsibility to the Fund's officers to agree whether CBRE or LGIM or another managers are best placed to meet the Fund's needs.
- We also recommend that the Committee meet Infrastructure Debt managers that other ACCESS members have recently allocated to.
- Lastly we propose that a full review of the private equity portfolio be undertaken, as well as discussions on the target composition of the listed equity portfolio for the next Committee meeting. This will establish where further funding of the real assets portfolio will come from.

APPENDIX

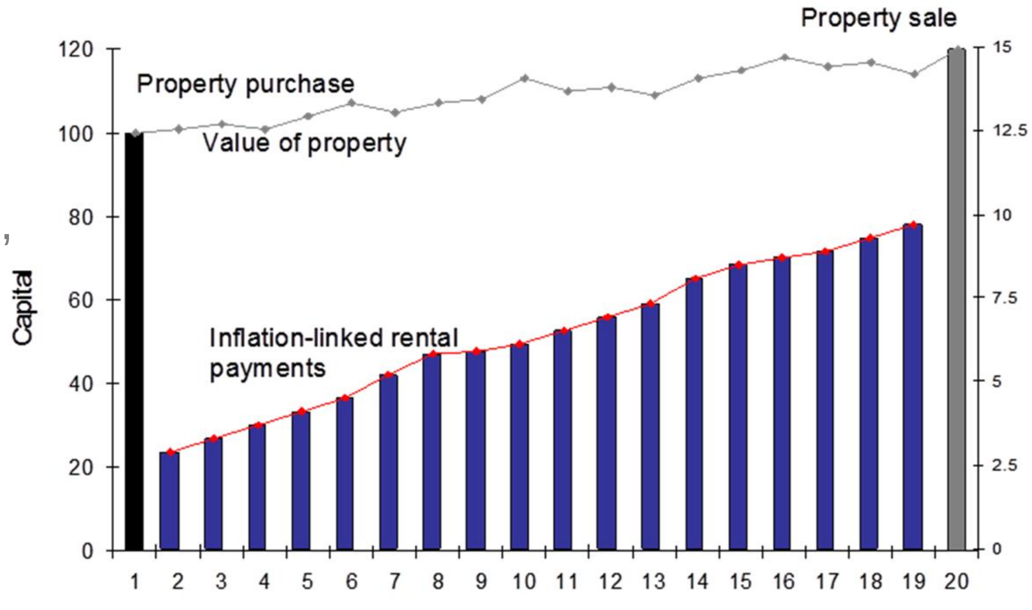
IMPLEMENTATION
LGIM EQUITIES TIDY UP

Asset Class	Actual Asset Allocation			
	Start of Quarter (£m)	End of Quarter (£m)	Start of Quarter (%)	End of Quarter (%)
UK Equity	131.5	137.1	15.8	15.6
North America Equity	273.8	287.0	32.8	32.6
North America Equity (GBP Hedged)	66.6	70.4	8.0	8.0
Europe (ex-UK) Equity	111.9	120.1	13.4	13.6
Europe (ex-UK) Equity (GBP Hedged)	94.6	101.5	11.3	11.5
Japan Equity	4.4	4.5	0.5	0.5
Japan Equity (GBP Hedged)	45.4	45.6	5.4	5.2
Asia Pacific (ex-Japan) Equity	9.7	10.8	1.2	1.2
Asia Pacific (ex-Japan) Equity (GBP Hedged)	40.1	43.2	4.8	4.9
Middle East/Africa Equity	1.7	1.7	0.2	0.2
Emerging Markets Equity	54.4	59.3	6.5	6.7
Total	**833.9**	**881.2**	**100.0**	**100.0**

- A secondary concern but the current LGIM structure a result of previous transitions (e.g. GTP) weights derived from efficient transition from previous mandates
- Are these ad hoc weightings appropriate? Can be tailored to provide overall exposure to global and UK equities if we have strong views on active managers (e.g. should we wish to keep both UK equity managers and retain confidence but wish to trim a global equity manager to a greater extent, the above could be reorganised to remove UK equities)
- Hedging levels inconsistent across regions

REAL ASSETS
HIGH LEASE VALUE PROPERTY (HLV)

- Long lease UK property with fixed income characteristics.
- Focus on income, not capital gains.
- Long leases with upward, often inflation-linked, rental growth:
  - Ideally over 20 years outstanding;
  - Unusual to have leases under 15 years outstanding.
- High tenant quality:
  - Government; high quality corporates.



Illustrative

Source: Prudential M&G

- Secure, long-term, predictable cash flows:
  - The long leases and high tenant quality mean a significant part of the property value is in the income;
  - Less exposure to property market capital fluctuations than other sectors of the market.

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REAL ASSETS
HIGH LEASE VALUE PROPERTY (HLV)

INVESTMENT THESIS

- HLV Property is long term UK property with fixed income characteristics, high credit quality tenants
- Displays lower volatility than 'core' property
- Secure, long-term, predictable cashflows with some inflation protection inherent in the rental uplifts
- The rent received is a significant proportion of the overall return from the property
- **Real** yields 3.5%-4% p.a. currently available (compared with -1.5% real yields on index-linked gilts) so expected returns are, say, 4% plus inflation over the longer term (6%-7% p.a.)

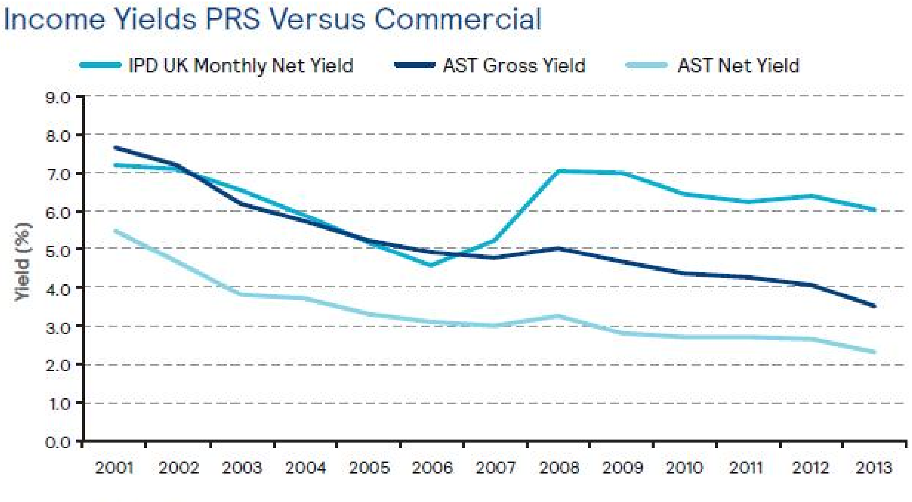
RISKS

- Risk Profile: Moderate
- Due to longer leases, credit and default risk are higher
- Illiquid
- Mark-to-market pricing implicated by wider property market
- Transactions of this type and in these sectors can be complex
- Still an investment in property so there still will be some risks associated with lease renewal, supply/demand etc.

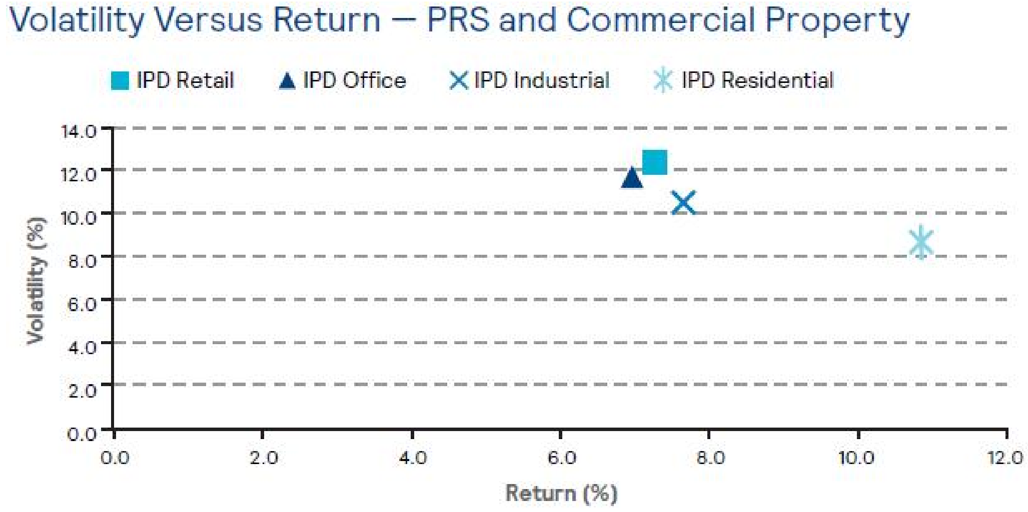
Note: number of managers offer HLV funds highly rated by Mercer, including Legal & General, M&G, Aviva and Standard Life

REAL ASSETS
PRIVATE RESIDENTIAL PROPERTY (PRS)

- We would expect the returns on PRS to be less than those from commercial property, however we would also view the risk as slightly lower
- Leases are generally structured as 12 month assured shorthold tenancies (ASTs), compared to leases on commercial properties which are generally much longer, around seven to nine years



Source: IPD



Sources: IPD, Datastream

Performance from 2001 - 2013

- Given strong capital appreciation PRS has outperformed over the period shown, however with lower yields it is difficult to argue that in the future PRS will outperform commercial property

REAL ASSETS
PRIVATE RESIDENTIAL PROPERTY (PRS)

- In theory, there are a variety of ways to access PRS with opened-ended and closed-ended funds available, although there are only a few rated by Mercer. Possible managers Legal & General, M&G.

INVESTMENT THESIS

- Introduces additional sources of return to the Fund
- Provides diversification from other asset classes, low correlation to traditional assets
- Inflation linkage with rent increase
- Potential for real added value from managers
- Expected return made up of say 2%-3% net initial yield plus 3%-4% growth in income, perhaps 5%-7% p.a. overall

RISKS

- Risk: Low-medium
- Are prospective returns attractive enough?
- Regulation/government changes to tax/rent
- Asset class still in its infancy
- Residential property market has cooled but it is demographics (demand for rented properties) not capital values (house prices) that drive returns

Note: As institutional-quality stock generally needs to be built from scratch (rather than existing assets acquired), the time taken to actually invest may be 12 months or possibly more, depending on the particular fund's pipeline of properties.

REAL ASSETS
INFRASTRUCTURE DEBT

- Two main forms:
  - public (e.g. Network Rail bonds);
  - but more commonly, private.
- Private (often unlisted and unrated) issued by infrastructure businesses to finance:
  - Capital expenditure;
  - Acquisitions;
  - Ongoing asset ownership.
- Pricing and wider terms are tailored to each transaction. Current pricing for high quality infrastructure debt perhaps gilts +c2% p.a.
- High portfolio concentration. Often only 8 – 12 individual investments, especially in early years.

Infrastructure Characteristics
Barriers to Market Entry
Inelastic Demand
Economies of Scale
Long Useful life

- Stable cash flows and high operating margins from infrastructure support relatively high debt levels:
  - Means risk levels are lower than other sectors of private debt for a given degree of leverage;
  - Commensurate reduction in expected returns compared to other private debt; but
  - ‘trades off ‘credit risk for liquidity risk.
- Few managers offer infrastructure debt funds, Allianz and Macquarie are two specialists in this field

REAL ASSETS
INFRASTRUCTURE DEBT

Investment Thesis

- Infrastructure can be thought of as the physical assets and their associated services that are essential for the functioning of modern society
- Relatively stable and predictable income stream over time, with some linkage to inflation (either explicit or implicit)
- Returns on the underlying infrastructure assets weakly correlated to traditional equity and bond markets
- Typically backed by a first security position that allows lenders to take control of asset in default:
  - As assets are stable and income-producing, default rarely occurs

Risks

- Risk Profile: Low/Moderate
- Infrastructure is very illiquid and difficult to value
- Gearing is often deployed and varying degree of control over assets
- Environmental (impaired value, legal damages)
- Regulatory (changed pricing rules) and/or political (nationalisation / regime change)
- Agency risk

Note: Ability to invest will depend on a manager raising a fund of suitable quality, which will occur from time-to-time.

REAL ASSETS
SUMMARY

HLV PROPERTY

- Return c4% p.a. real
- Investment grade quality
- Several managers/funds available including Legal & General, Standard Life
- Could take up to 12 months to be invested

PRS PROPERTY

- Return 5%-7% p.a. with some inflation linkage
- Small number of funds available including Legal & General, M&G
- Could take 12 months to be invested

INFRASTRUCTURE DEBT

- Return Gilts +c2% p.a.
- Investment grade quality
- Funds raised by high quality managers from time to time
- Managers include Allianz and Macquarie

MERCER

MAKE TOMORROW, TODAY