Bath & North East Somerset Council

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4 December 2015
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To: All Members of the Avon Pension Fund Committee

Bath and North East Somerset Councillors: David Veale (Chair), Christopher Pearce (Vice-Chair), Paul Myers, Cherry Beath and Shaun McGall

Co-opted Voting Members: Councillor Steve Pearce (Bristol City Council), Councillor Mary Blatchford (North Somerset Council), Councillor Mike Drew (South Gloucestershire Council), William Liew (HFE Employers), Richard Orton (Trade Unions), Ann Berresford (Independent Member) and Shirley Marsh (Independent Member)

Co-opted Non-voting Members: Cheryl Kirby (Parish and Town Councils), Steve Paines (Trade Unions) and Wendy Weston (Trade Unions)

Chief Executive and other appropriate officers
Press and Public

Dear Member

Avon Pension Fund Committee: Friday, 11th December, 2015

You are invited to attend a meeting of the **Avon Pension Fund Committee**, to be held on **Friday, 11th December, 2015** at **2.00 pm** in the **Kaposvar Room - Guildhall, Bath**

The agenda is set out overleaf.

Yours sincerely

Sean O'Neill
for Chief Executive

If you need to access this agenda or any of the supporting reports in an alternative accessible format please contact Democratic Services or the relevant report author whose details are listed at the end of each report.

This Agenda and all accompanying reports are printed on recycled paper

NOTES:

1. **Inspection of Papers:** Any person wishing to inspect minutes, reports, or a list of the background papers relating to any item on this Agenda should contact Sean O'Neill who is available by telephoning Bath 01225 395090 or by calling at the Guildhall Bath (during normal office hours).

2. **Public Speaking at Meetings:** The Council has a scheme to encourage the public to make their views known at meetings. They may make a statement relevant to what the meeting has power to do. They may also present a petition or a deputation on behalf of a group. Advance notice is required not less than two full working days before the meeting (this means that for meetings held on Wednesdays notice must be received in Democratic Services by 4.30pm the previous Friday)

   The public may also ask a question to which a written answer will be given. Questions must be submitted in writing to Democratic Services at least two full working days in advance of the meeting (this means that for meetings held on Wednesdays, notice must be received in Democratic Services by 4.30pm the previous Friday). If an answer cannot be prepared in time for the meeting it will be sent out within five days afterwards. Further details of the scheme can be obtained by contacting Sean O'Neill as above.

3. **Recording at Meetings**:-

   The Openness of Local Government Bodies Regulations 2014 now allows filming and recording by anyone attending a meeting. This is not within the Council's control.

   Some of our meetings are webcast. At the start of the meeting, the Chair will confirm if all or part of the meeting is to be filmed. If you would prefer not to be filmed for the webcast, please make yourself known to the camera operators.

   To comply with the Data Protection Act 1998, we require the consent of parents or guardians before filming children or young people. For more information, please speak to the camera operator

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4. **Details of Decisions taken at this meeting** can be found in the minutes which will be published as soon as possible after the meeting, and also circulated with the agenda for the next meeting. In the meantime details can be obtained by contacting Sean O'Neill as above.

   Appendices to reports are available for inspection as follows:-

   Public Access points - Reception: Civic Centre - Keynsham,- Bath, Hollies - Midsomer Norton, and Bath Central, Keynsham and Midsomer Norton public libraries.

For Councillors and Officers papers may be inspected via Political Group Research Assistants and Group Rooms/Members' Rooms.

5. **Attendance Register:** Members should sign the Register which will be circulated at the meeting.

6. THE APPENDED SUPPORTING DOCUMENTS ARE IDENTIFIED BY AGENDA ITEM NUMBER.

7. **Emergency Evacuation Procedure**

   When the continuous alarm sounds, you must evacuate the building by one of the designated exits and proceed to the named assembly point. The designated exits are sign-posted.

   Arrangements are in place for the safe evacuation of disabled people.

Avon Pension Fund Committee - Friday, 11th December, 2015

at 2.00 pm in the Kaposvar Room - Guildhall, Bath

A G E N D A

1. EMERGENCY EVACUATION PROCEDURE

   The Chair will ask the Committee Administrator to draw attention to the emergency evacuation procedure as set out under Note 8.

2. APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

3. DECLARATIONS OF INTEREST

   At this point in the meeting declarations of interest are received from Members in any of the agenda items under consideration at the meeting. Members are asked to complete the green interest forms circulated to groups in their pre-meetings (which will be announced at the Council Meeting) to indicate:

   (a) The agenda item number in which they have an interest to declare.

   (b) The nature of their interest.

   (c) Whether their interest is a **disclosable pecuniary interest** or an **other interest**, (as defined in Part 2, A and B of the Code of Conduct and Rules for Registration of Interests)

   Any Member who needs to clarify any matters relating to the declaration of interests is recommended to seek advice from the Council's Monitoring Officer or a member of his staff before the meeting to expedite dealing with the item during the meeting.

4. TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

5. ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

6. ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

   To deal with any petitions or questions from Councillors and where appropriate co-opted and added members.

7. MINUTES: 25 SEPTEMBER 2015 (Pages 7 - 14)

8. LGPS POOLING OF INVESTMENTS - UPDATE (Pages 15 - 96)

9. MIFID II - IMPLICATIONS FOR LGPS FUNDS (Pages 97 - 100)

10. INTERIM VALUATION AND 2016 VALUATION PROCESS (Pages 101 - 156)

11. REPORT ON INVESTMENT PANEL ACTIVITY (Pages 157 - 180)

12. INVESTMENT PERFORMANCE AND STRATEGY MONITORING REPORT (Pages 181 - 246)

13. BUDGET AND CASHFLOW MONITORING REPORT (Pages 247 - 256)

14. PENSION FUND ADMINISTRATION - PERFORMANCE INDICATORS AND RISK REGISTER (Pages 257 - 282)

15. INTERNAL DISPUTES RESOLUTION PROCEDURE (Pages 283 - 294)

16. WORKPLANS (Pages 295 - 306)

The Committee Administrator for this meeting is Sean O'Neill who can be contacted on 01225 395090.

Protocol for Decision-making

Guidance for Members when making decisions

When making decisions, the Cabinet/Committee must ensure it has regard only to relevant considerations and disregards those that are not material.

The Cabinet/Committee must ensure that it bears in mind the following legal duties when making its decisions:

- Equalities considerations
- Risk Management considerations
- Crime and Disorder considerations
- Sustainability considerations
- Natural Environment considerations
- Planning Act 2008 considerations
- Human Rights Act 1998 considerations
- Children Act 2004 considerations
- Public Health & Inequalities considerations

Whilst it is the responsibility of the report author and the Council's Monitoring Officer and Chief Financial Officer to assess the applicability of the legal requirements, decision makers should ensure they are satisfied that the information presented to them is consistent with and takes due regard of them.

Bath and North East Somerset Council

AVON PENSION FUND COMMITTEE

Minutes of the Meeting held

Friday, 25th September, 2015, 2.00 pm

Bath and North East Somerset Councillors: David Veale (Chair), Christopher Pearce (Vice-Chair), Paul Myers and Cherry Beath

Co-opted Voting Members: Councillor Steve Pearce (Bristol City Council), Councillor Mary Blatchford (North Somerset Council), Cllr John Goddard (South Gloucestershire Council), William Liew (HFE Employers), Richard Orton (Trade Unions), Ann Berresford (Independent Member) and Shirley Marsh (Independent Member)

Co-opted Non-voting Members: Cheryl Kirby (Parish and Town Councils) and Wendy Weston (Trade Unions)

Advisors: Steve Turner (Mercer), Tony Earnshaw (Independent Advisor) and Paul Marsland (Manifest)

Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions), Liz Woodyard (Investments Manager), Matt Betts (Assistant Investments Manager), Geoff Cleak (Pensions Benefits Manager), Martin Phillips (Finance & Systems Manager (Pensions)) and Alan South (Technical and Development Manager)

20 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

21 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Cllr Shaun McGall, Cllr Mike Drew and Steve Paines.

22 DECLARATIONS OF INTEREST

There were none.

23 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

24 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

Questions were received from Susan Johnson, a Fund member and from Fossil Free Bristol. The questions and answers are set out in the Appendix to these minutes.

Richard Lawrence of Fossil Free Bristol also made the following statement:

> We are pleased to see that Bristol Unison now support our campaign, as well as Transition Bath, and we continue to work to bring light to our campaign across the Avon area. And in the global fossil fuel divestment campaign, we can report that so far more than 400 institutions and 2,000 individuals have pledged to divest from fossil fuels. Recent notable commitments include the California Public Employees' Retirement System, the Norway Pension Fund, the Canadian Medical Association, the World Council of Churches, the University of California, Leonardo DiCaprio and the Leonardo DiCaprio Foundation.

25 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

Two questions were submitted by Councillor Lin Patterson. These and the answers to them determined at the meeting are included in the Appendix.

26 MINUTES: 26 JUNE 2015

The public and exempt minutes of the meeting of 26 June 2015 were approved as a correct record and signed by the Chair.

27 AUDITED STATEMENT OF ACCOUNTS, ANNUAL GOVERNANCE REPORT & ANNUAL REPORT - 2014/15

The Finance & Systems Manager (Pensions) presented the report. He invited the Committee to note the final audited Statement of Accounts before their submission to the Corporate Audit Committee. He said that only significant change since the draft accounts were presented to the June meeting of the Committee was a refund of contributions overpaid by Bristol City Council, which reduced the stated net value of the Fund by £4.542m. An overpayment of £2.188m had been known to the Fund at 31 March 2015. The discovery of the first overpayment had led Bristol City Council to review their systems, and a second overpayment of £2.388m had come to light as a result of this review. Because contributions are monitored against pensionable pay, Pensions officers had thought that BCC was overpaying and had alerted them to the issue.

Mr Morris commented on the Annual Governance Report, which was circulated as part of a supplement to the agenda. All controls were rated green, apart from an issue relating to journals (supplement page 54), which was rated as amber. In a reply to a question from a Member, he confirmed that the auditors were satisfied with the separation of the Fund's banking arrangements from those of the Council. Responding to a question from a Member about the auditor's recommendation to separate the Pensions accounts from the Council's within the ledger system, the Head of Business, Finance and Pensions said that an assessment would have to be made of the complexity of extracting and separating the Fund's accounts, adding that there was an ongoing national debate about further separating LGPS Funds from their administering authorities and increasing their independence.

The Letter of Representation from the S151 Officer to the Auditor was circulated and approved at the meeting.

The Finance & Systems Manager (Pensions) invited Members to approve the Annual Report.

RESOLVED

1. To note the final audited Statement of Accounts for 2014/15.

2. To note the issues raised in the Annual Governance Report.

3. To approve the draft Avon Pension Fund Annual Report 2014/15.

28 ANNUAL RESPONSIBLE INVESTMENT REPORT

The Investment Manager presented the report.

Paul Marsland gave a presentation on Manifest's Monitoring Review of Shareholding Voting 2014 (Appendix 2 to the report).

A Member said that he found it difficult to see what concrete benefit had emerged from shareholders raising issues, as companies rarely seemed to modify their policies as a result. Many companies were owned by large institutions, who responded to market events, not issues raised by shareholders. Mr Marsland replied that it was important to consider the whole context in which company investment decisions took place; the voting record was only one aspect.

Another Member suggested that better reporting was needed from investment managers in relation to asset valuations in particular. Company reporting of assets could be very misleading. For example, an oil company might report 40-50 years of extractable reserves, whereas in 20 years' time most cars would be electric. Similar concerns applied to banks' valuation of their property valuations. He would like to see evidence of how our investment managers engaged with companies to interrogate their valuation of their assets. The Investments Manager replied that these issues were pursued through LAPFF, and could be raised in meetings the Investment Panel have with managers. The Member responded that it was important that the Fund's stakeholders knew that the Fund was engaging with these issues.

RESOLVED to approve the Responsible Investment Report for 2014/15.

29 LGPS UPDATE - POOLING OF INVESTMENTS

The Head of Business, Finance and Pensions presented the report. He said that the Government had returned to this theme in the July budget statement. He believed that the LGPS schemes in the South West had a good record of co-operation, but it was now inevitable that LGPS funds would be required to have some form of pooled investment arrangements. Funds were expected to produce their own proposals this autumn, with formal agreement of the proposals in January/February 2016. Members were invited to approve in principle the setting up of a South West Collective

Investment Vehicle and to authorise officers to continue work with neighbouring funds to develop proposals for such a vehicle.

A Member asked whether Funds would be required to merge. The Head of Business, Finance and Pensions replied that there was nothing specific from Government about this at the moment. The Member said that he would be concerned about the ability of very large funds to move the market. A Member was concerned that these proposals had progressed so far without any consultation with the funds. He believed that governance structure should be looked at first. The Head of Business, Finance and Pensions agreed that governance was critical. The Investment Manager said that the Government would consult on the regulations, but would not consult on the principle of collective investment. They were simply going to instruct funds to do it.

After discussion Members felt it was premature to approve a collective investment vehicle in principle and requested that this recommendation be withdrawn.

RESOLVED to authorise the S151 Officer to continue work with neighbouring funds in the South West to explore proposals for a South West Collective Investment Vehicle or alternative.

30 REVIEW OF RESPONSIBLE INVESTING POLICY - SCOPE

The Investment Manager presented the report.

A Member suggested that the scope should be amended to indicate that representations made to the Committee from the public, of the kind received today, would be taken into consideration. He also asked whether £25,000 was sufficient for a review of this kind. The Investment Manager said that the fee was that indicated by Mercer. A Member suggested that paragraph 5.2 of the report was broad enough to include representations from the public without a specific reference to them. It was agreed that the scope was broad enough and did not to require a specific reference to them.

RESOLVED

1. To agree the scope for the Review of the Responsible Investing Policy as set out in section 5.1-5.3.
2. To agree the fund the costs of the review to an initial limit of £25,000.

31 THE PENSIONS REGULATOR - ADMINISTRATION - COMPLIANCE REPORTING

The Pensions Manager presented the report.

A Member suggested that a minimum limit should be placed on historic frozen refunds. She also wondered whether late contributions needed to be broken down by individual employer.

RESOLVED:

1. To note the report.

2. To agree Appendix C – Data Improvement Plan.

3. To agree Appendix D – Late Payers Report.

4. To agree to receive a quarterly monitoring report going forward combining the overall administration performance report.

32 REPORT ON INVESTMENT PANEL ACTIVIITY

The Assistant Investments Manager presented the report.

Members noted that the Panel had requested further information from the consultant about managing liabilities and had recommended that the Fund should continue to strategically hedge its exposure to currency risk.

RESOLVED

1. To note the recommendations and decisions made by the Panel since the last quarterly activity report, as set out in 4.1.

2. To agree the recommendations on currency hedging at 4.1.2(a) and points 1), 2) and 3) in Exempt Appendix 3.

33 REVIEW OF INVESTMENT PERFORMANCE FOR QUARTER ENDING 30 JUNE 2015

The Assistant Investments Manager presented the report. The funding level had fallen from 78% to c. 77% and the deficit had risen slightly from c. £1.07bn to c. £1.1bn, largely because of disappointing asset returns during the quarter. Falling gilt yields had increased the value of the liabilities over the 12 month period.

Mr Turner commented on the Mercer Investment Performance Report. He agreed with the suggestion made by a Member that the Bank of England would not raise the base rate until the Federal Reserve had done so, and that an increase in interest rates was largely priced into the market and the allocation to emerging markets should remain unchanged.

RESOLVED:

1. To note the information set out in the report.

2. To note LAPFF Quarterly Engagement Report at Appendix 4.

34 PENSION FUND ADMINISTRATION

The Finance & Systems Manager (Pensions) summarised the budget information as set out in section 4 and 5 of the report.

A Member asked about contribution rates. The Investment Manager replied that these were set at the triennial valuation. The rates reflected administration costs, not investment costs.

The Pensions Manager presented the performance report.

RESOLVED:

1. To note the administration and management expenditure incurred for 4 months to 31 July 2015.

2. To note the performance indicators and customer satisfaction feedback for 3 months to 30 June 2015.

3. To note the Summary Performance Report for period from 1 July 2011 to 30 June 2015.

4. To agree to review the full risk register once a year.

5. To agree to review the top 10 risks and changes quarterly.

35 CONSULTATION RESPONSES

The Technical Manager summarised the report.

Members discussed the proposed Exit Cap (paragraphs 5.1-5.5 and Appendix 2). One Member suggested that the proper approach would have been to change the rules of the LGPS rather than imposing this cap, while at the same time effectively allowing employers the final say on the benefits to be paid. As far as he understood, the Fund had never incurred costs because of employers' decisions about the redundancy of senior staff. The Head of Business, Finance and Pensions responded that Government was reacting to a perception that a large number of staff in the public sector were receiving extremely generous severance payments, and that this did not really fit in with the public sector ethos. The issue was how employers managed the exit of senior people, as the Fund did not incur additional costs.

RESOLVED:

1. To note the current update and the response made by Bath and North East Somerset Council in connection with the Exit Payment Cap consultation.

2. To approve the response letter regarding the pension tax relief consultation.

36 WORKPLANS

The Investment Manager presented the report.

RESOLVED to note the workplans and training programme for the relevant periods.

37 TIMING OF FUTURE COMMITTEE MEETINGS AND TRAINING SESSIONS - VERBAL REPORT

The Head of Business, Finance and Pensions introduced this item. He said that a request had been received from a Member who found it difficult to attend meetings on a Friday afternoon that the Committee should consider holding changing its current meeting schedule.

The majority of Members felt that on balance they were content with the present meeting schedule and did not think that it should be altered.

It was agreed that the Committee Administrator should send the meeting schedule to Democratic Services in Bristol City Council, North Somerset and South Gloucestershire and issue invitations to Members for each meeting via the Outlook calendar.

The meeting ended at 4.01 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services

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Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND COMMITTEE**	
MEETING DATE:	**11 December 2015**	**AGENDA ITEM NUMBER**
TITLE:	**LGPS Update – Pooling of Investments**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Letter from DCLG, 7 October 2015 Appendix 2 – Letter from LGA, 3 November 2015 Appendix 3 – LGPS: Opportunities for collaboration, cost savings and efficiencies (2014) – DCLG consultation response Appendix 4 – LGPS: Investment Reform Criteria and Guidance		

1 THE ISSUE

1.1 At the September meeting the Committee discussed the government's initiative to pool LGPS investment assets and authorised the S151 Officer to continue work with neighbouring funds in the South West to explore proposals for a South West Collective Investment Vehicle or alternative structure.

1.2 This report is to update the Committee on further progress. A verbal update will be given at the meeting.

2 RECOMMENDATION

That the Committee

2.1 **Notes the information in this report.**

2.2 **Agrees to delegate to a working party, the approval of any proposals or expenditure relating to the project, having circulated any proposals to Committee members for comment/views.**

2.3 **Agrees the two Committee members to be on the working party in addition to the Chair and Vice Chair.**

3 FINANCIAL IMPLICATIONS

3.1 There is no provision in the 2015/16 budget for specialist advice relating to the pooling of investments. At its meeting in September 2015, the Committee gave the S151 Officer authorisation to explore options with other funds in the SW. To date, the advisory costs for the Options Appraisal and Business Case incurred by the Fund have been £13,500. The 2016-17 budget will include a provision to deliver the final proposal due in 2016 expected to be in the region of £25,000 plus costs of extra resources to support the investments team during 2016-17 whilst work is being done for the project.

3.2 There will be costs associated with setting up a pooled arrangement and ongoing management costs once the arrangement is established. These will be costed once there is a decision as to the pooling arrangements to be established. These set up costs will be offset by the savings arising from pooling over the medium/longer term.

4 UPDATE

4.1 Since the September meeting the following has developed:

a) At the Conservative Party conference the Chancellor announced there will be c. 6 pooled funds across the country, "British wealth funds" that will be more able to invest in infrastructure.

b) The DCLG then issued a letter to the LGA and administering authorities about the pooling of investments and investing in infrastructure - see Appendix 1.

c) Following a series of seminars with officers and Committee Chairs, the LGA issued a letter to Chairs of Pension Committees on 3 November - see Appendix 2.

d) As part of the Autumn Statement the following were issued by the DCLG:

(i) LGPS: DCLG response to the consultation "Opportunities for collaboration, cost savings and efficiency (which ran from 1 May to 11 July 2014) – see Appendix 3.

(ii) LGPS: Revoking and replacing the LGPS (Management and Investments of Funds) Regulations 2009.

(iii) LGPS: Investment Reform Criteria and Guidance – see Appendix 4.

4.2 Appendices 1-3 are included for information only.

4.3 The investment regulations need to be amended to allow effective pooling of assets. In addition the backstop regulations permitting government intervention if funds do not pool their assets form part of these regulations. The Fund's response to this consultation will be circulated for comments prior to the deadline.

4.4 The key points from the Investment Reform Criteria and Guidance (Appendix 4) are:

a) Criteria:

(i) Pools must be at least £25bn in assets to achieve benefits of scale

(ii) Pools must demonstrate strong governance and decision-making both within the pooling structure and the local level

(iii) Pools must demonstrate reduced costs and excellent value for money: how substantial savings in investment fees will be delivered both in the near term and over the next 15 years, while at least maintaining overall investment performance.

(iv) Active fund management should only be used where it can be shown to deliver value for money.

(v) Pools should improve the capacity to invest in infrastructure.

b) Timetable:

(i) 19 February 2016 – Initial pooling proposal to include a commitment to pooling, description of progress made towards formalising arrangements with other funds;

(ii) 19 February 2016 - deadline for draft investment regulations consultation which are intended to come into force from 1 April 2016.

(iii) 15 July 2016 – detailed pooling proposal that demonstrates how the criteria is met.

5 SOUTH WEST PROJECT

5.1 The SW group continues to explore its options and develop the pooled structure. The group issued a press release in October to announce we are working on a collaborative solution.

5.2 The report on the initial work exploring possible structures has been circulated to the Committee. Further work is ongoing to develop the business case for the initial proposal to be put to the government.

5.3 The Council's Monitoring Officer has confirmed that any decision to pool investment assets would need approval by Council. It is intended that the Committee will approve the final proposal prior to it being submitted to the Council.

5.4 As the timetable for decisions regarding pooling proposals will not necessarily coincide with the Committee cycle, it is proposed a working party drawn from members of the Committee is established to work with officers. It is proposed that the working party will comprise the Chair, Vice Chair plus two further members.

5.5 The Committee is asked to agree the following delegation to the working party:

a) To approve any proposals or expenditure relating to the project, having circulated any proposals to committee members for comment/views.

5.6 There will be a verbal update of latest developments at the meeting.

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary.

8 CONSULTATION

8.1 N/a

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 Set out in the report.

10 ADVICE SOUGHT

10.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Woodyard, Investments Manager 01225 395306
Background papers	
Please contact the report author if you need to access this report in an alternative format	

Department for Communities and Local Government

Chris Megainey
Deputy Director
Workforce, Pay and Pensions

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7 October 2015

Jeff Houston
Head of Pensions
Local Government Association
Smith Square
London SW1P 3HZ

Dear Jeff,

On Monday, the Chancellor of the Exchequer unveiled a major four point plan to get Britain building for the future, announcing changes to the way vital infrastructure projects are planned, determined and funded.

The Secretary of State, Greg Clark, wrote to Lord Porter after the July Budget, setting out how we intended to work with local government pension scheme administering authorities to bring forward proposals to invest collectively and deliver savings. The Chancellor's announcement at the Conservative Party Conference builds on the discussions that we have been taking forward with the sector following the Budget, but places infrastructure investment, alongside delivering efficiencies, at the heart of the policy.

The LGPS Funds as currently constituted are too small and fragmented to have the capacity and capability to be a major investor in UK infrastructure. This is why the Chancellor announced that we are going to work with administering authorities to bring together investments into up to six pools spread across the country, creating the conditions to save hundreds of millions in costs and invest billions in infrastructure in the regions.

The Government remains keen to see authorities take the lead in identifying the best way to deliver savings and drive infrastructure investment and, as announced at the Budget, we will shortly be inviting administering authorities to bring forward proposals to deliver pooled investments that meet published criteria. I look forward to continuing to work with you, local authorities and the investment management industry over the next few weeks as we finalise those criteria.

I am copying this letter to each administering authority in England and Wales.

CHRIS MEGAINEY

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Local Government Association

To Chairs of Pension Committees

Wednesday, 3 November 2015

Dear Colleague

Local Government Pension Scheme - Pooling of investments

I know that you will be aware that in the summer budget the government announced that it would seek to work with local government to pool the investments of the LGPS in order to implement fee savings without any detriment to returns.

The Secretary of State wrote to me on 10th July outlining the background to the announcement and setting a challenge to the sector to come forward with proposals to meet the objectives of government.

Since then the LGA both directly and through its representation on the LGPS Advisory Board has sought to provide a voice for and support to its members in this task. In particular we have been clear to government that issues around cost, timing, transition, effective asset allocation and political accountability back to local funds must be very carefully considered. We have also arranged a number of opportunities for representatives of the sector to meet with and question government those officials tasked with implementing the policy.

The latest of these, a session for chairs of LGPS pension committees, took place on Friday 16th October. Over a third of LGPS funds attended as well as officials from both DCLG and HM Treasury and the meeting provided the opportunity to both hear about the timeline and objectives as well as participate in a lively debate.

A briefing note is attached to this letter giving the latest position and how the LGA continue to provide your fund with an input to and support for this process.

Cllr Roger Phillips is the LGA lead on this matter and would be happy to discuss any issues, ideas or views you may have.

Yours sincerely

Porter of Spalding

Lord Porter of Spalding CBE
Chairman

Local Government House, Smith Square, London SW1P 3HZ **T** 020 7664 3000 **F** 020 7664 3030 **E** info@local.gov.uk www.local.gov.uk

LGA Briefing: Pooled investments

This briefing sets out the policy clarification emerging since the Summer Budget announcement on pooling investments in the LGPS.

Background

1. On 7th July the chancellor made two announcements (one via the red book, the other in the speech) that will have an impact on the LGPS.

2. The first, and of more immediate concern, was the announcement of a consultation on legislation for delivering savings via the use of pooled investment vehicles for LGPS fund assets.

3. The document which accompanies the budget and is published immediately the chancellor sits down (the red book) contains the detail of the major announcements made in the chancellor's speech to the House together with those announcements which for whatever reason were not included in the speech.

4. The red book contains at page 78 the following section

   2.19 Local Government Pension Scheme pooled investments *– The government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments.*

5. This briefing sets out the clarification on policy which has emerged since the Summer Budget announcement on pooled investments. It includes the key messages which are now becoming clear; a brief note of the meetings held on the subject; and a description of the options for pooling currently under discussion.

Key messages

6. Since the budget announcement the following key messages have emerged in discussion with DCLG/HMT officials:

   a) Proposals for pooling will need to be assessed against criteria to be set by government. The budget statement is potentially misleading in that the consultation on the criteria is happening now not in the autumn.

   b) Criteria are likely to be around size (£30b has been used as an illustrative example), cost and governance. However there will be no specific savings target in the cost criterion. A forth criterion on infrastructure is expected to be added following the chancellor's speech to the Conservative party conference on 5th October.

   c) This additional criterion is not expected to be prescriptive but will aim to provide an environment in which cost effective infrastructure investment opportunities may be better accessed by the LGPS.

   d) We expect the criteria will likely be published in November alongside a consultation on:

      - new investment regulations (with the removal of any limits or restrictions which would prevent pooling); and
      - 'back stop' legislation which will apply if any fund is not invested via a vehicle/s which meet the criteria;

   e) Thoughts about pooling models and options should be underway now with a view to proposals on a direction of travel (likely pools and which funds will be in them) going to ministers early next year. Further and more, detailed proposals would then be expected later in 2016.

   f) Announcement by government on the way forward likely in Spring 2016.

g) Asset allocation is to be left at the local level, but as yet there is no guidance on the exact nature of this allocation (e.g. at the class or sub class level?).

h) Government has no fixed ideas on the structure of pools (CIV, CIF, joint procurement etc.) that decision is being left to the sector.

i) Government has no fixed ideas on type of pools (regional, multi asset or single asset) again, that decision is with the sector. However it has expressed a preference for a 'simple' solution.

j) Government is alive to the transitional issues for example illiquid vehicles that cannot be unwound in the short term without significant financial penalties. It is also aware of the time that structures such as the London CIV have taken to set up. However it will probably expect pooled vehicles to be in place in this parliament even if all assets will not be ready to be moved within that timeframe.

k) There may be a place for a proportion of the assets to remain under direct local control in certain circumstances. However any such exemptions would probably be for prescribed investments and will be small.

Meetings

7. A number of recent meetings have taken place on this subject organised both by the LGA, in response to a request from DCLG to facilitate discussions with stakeholders, and the Scheme Advisory Board (SAB).

8. LGA organised a fund officers/DCLG/HMT meeting on the 17th August, followed up with a further meeting on the 7th September, to encourage thinking around the criteria and possible models. The key outputs of these meetings were that funds:

- Remain unconvinced that there are any intrinsic benefits of scale especially for in house teams with already low costs.
- Do not see CIVs as the only method of pooling.
- Interpret 'asset allocation' in a number of different ways.
- Can see some benefits to pooling in some asset classes but would want to retain some local discretion.
- Anticipate reduced fees especially for alternatives, provided pools are well governed.

9. The LGA also organised an investment managers DCLG/HMT meeting on 24th August to solicit the views of the industry. The key outputs of this meeting were that managers:

   - Were less concerned about the background structure of any pool and more concerned on the need for it to present itself as one client.
   - Would encourage as much decision making as possible be placed within the pools in order to achieve the greatest savings.
   - That pools if structured correctly could provide the 'sticky mandates' necessary to remove unnecessary churn.

10. The SAB held an open invitation session on 21st August for all funds. There were over 60 attendees (the vast majority officers) representing 45 funds. A copy of the Q&A from this session is attached as **ANNEX 1**.

11. LGA held a meeting for chairs of pension committees on 16th October. A number of issues were raised mainly around timing of proposals, the need to obtain political agreement, the potential exemptions and the potential for competing pools. The issue of co-ordination in order to ensure that all funds are involved in the proposals was also raised.

Potential models

12. Making an assumption that around £30b is the target for multi asset pools, with perhaps a smaller number for single asset pools which could be

evidenced to operate better at the national level; then a number of potential options for pooling emerge:- PLEASE NOT LGA are not supporting, proposing or seeking to achieve any of these options and the following are listed for information only

- Six or seven[1] regional multi asset pools
- Six or seven national multi asset pools - funds could join pools with similar investment strategies or methodologies (e.g. in-house)
- Four or five multi asset pools (regional or national) with a single national framework for passive
- Four or five multi asset pools with a national pool for a single asset class (e.g. infrastructure)
- Four or five multi asset pools with a single national framework for passive and a national pool for a single asset class
- Three or four multi asset pools with single national framework for passive, a national pool for a single asset class (e.g. infrastructure) and a single pool for fixed liabilities (e.g. a pensioner pool)

13. For pools themselves there are a number of different potential structures which are under consideration these being:

    - Joint procurement (e.g. the passive framework)
    - Joint vehicles (e.g. the LPFA/GMPF infrastructure pool)
    - Combined vehicles (e.g. the London CIV and Lancs/LPFA models)
    - Delegated functions (e.g. section 101(5) committee with lead authority)

14. For the latter two a degree of in-house management is being considered either to replicate what is already there or to build extra capacity.

15. In order for funds to be able to compare a number of the options a group of LGPS funds are working with Hymans Robertson to undertake an analysis of

[1] Depending on the participation of Welsh funds in cross border pools or one Welsh pool.

options with a view to assessing how each performs against the following criteria:

- Size - are the multi asset pools sufficient to meet the assumed government criteria of £30b, are the other vehicles optimally sized for their class or method?
- Costs - what are the estimated gross savings for each option?
- Governance - how do each of the models provide political structures and behaviours that encourage best practice outcomes (e.g. long term investment)?
- Local political direction - who is working with who already, where are the obvious fits?
- Central political direction - are there other policy drivers which the options best fit with (e.g. combined authorities)?
- Impact on competition - both in the manager market and between pools.
- Legislative requirements - what is needed and what would be the time frame needed?

16. The data from the above analysis will be made available to the stakeholders and in this respect the LGA's Head of Pensions will liaise with the steering group managing this work.

How LGA can help

17. The LGA pensions team can provide cross scheme data from the Scheme Annual Report to enable funds to assess the potential assets pools across England and Wales.

18. LGA can co-ordinate the process by making funds aware of the pooling projects underway and providing a central contact point for funds who are exploring their options and may wish to talk to more than one project.

19. The LGA Head of Pensions is able to attend joint or single meetings of officers and/or elected members in order to set out the background and current understanding of the process.

20. The LGA can make representation on behalf of LGPS funds back to government and/or facilitate contact with DCLG and HM Treasury officials who are leading on the process.

21. If you would like further information on how the LGA can provide support please contact:

Cllr Roger Phillips LGA lead member on pensions:
rjphillips@herefordshire.gov.uk

Jeff Houston Head of Pensions:

jeff.houston@local.gov.uk

October 2015

ANNEX 1

Questions received for 21st August Pooled Investment Event.

Q1. The current regulatory framework within which the LGPS operates makes it difficult for funds to collaborate on investments without a requirement to achieve FCA registration which entails additional cost and complexity. It should be possible to revise the Investment Regulations to allow funds to work together, within guidelines, without unnecessary regulation.

Are ministers receptive to a revision of the regulatory framework to enable funds to work together more easily? If so, will this be undertaken at the same time as the pooling consultation?

A1. Yes, as part of the package, government will consult on revising the investment regulations. It has been noted that the initiatives to be implemented in the near term, i.e. the London CIV, have needed to work through barriers in order to get the current stage. Amended investment regulations would be required to facilitate ease of implementation of investment pooling without having to establish third party companies and FCA regulation.

Q2. How do low cost internally managed LGPS schemes fit into their view for the LGPS?

A2. The intention is for all LGPS assets to be pooled, there will not be exemptions for any fund. However, the package for the LGPS is deliberately not over-prescriptive. The criteria for investment pools will include some detail on governance, size, and cost, but it will be up to LGPS funds to work together to uphold proposed investment pools against the criteria.

There is an issue of scale to address, and a need to collaborate with others with the same goals. Government can help proposals through regulatory change.

Q3. Funds are required to demonstrate cost savings, however as investment arrangements are income contracts as returns improve you pay higher fees, arguably you want to be paying more as it demonstrates you are earning more? Is "cost savings" the right question or should it be "Value for Money"?

A3. Both costs and the return on investments are important. It is recognised that i) there are industry-wide issues with investment expenses transparency, and ii) each fund will be starting from a different point. There is evidence to suggest larger pools may be more cost effective, benefitting from economies of scale. The government is *looking at a timescale longer than term of office for any cost savings to fully materialise. Without having set the criteria, questions around demonstrating cost savings against them are difficult to answer.*

Q4. There has not been any work to achieve a consistent fee base or fee budget for the wider LGPS to measure against, so how is the integrity of fee saving submissions established.

A4. LGPS policy has moved on from 2013 when the call for evidence brought investment costs into focus and ignited the passive versus active debate. Since then it has been shown that LGPS Funds had managed to negotiate competitive fee bases. Fee savings are one of the reasons, but not the primary reason, for pooling investments. As above, the criteria have not been set, nor the nature of the pools; therefore submissions would need to be backed up with evidence.

Q5. How are CIV structures more likely to generate savings over shared procurement initiatives, especially as CIV's have an operating cost, governance and access challenges to overcome?

A5. The policy intention would not be met by frameworks and/or procurement initiatives alone. If the end result is that the investments of the LGPS are to be held in four or five robust CIVs, similar to the London CIV, the government would not be disappointed. CIVs, however, were not prescribed in the budget, and there are other, just as acceptable, means for investment pooling.

One of the long term detractors in performance is investment manager turnover; its extent would be reduced as a result of pooling investments. The eventual solutions would need to be considered, backed up by research and require a lead in time to implementation.

Q6. How do we ensure that our proposals are not a patchwork quilt many of which may not meet the size criteria and/or overlap with each other? Do we need a moratorium on any new initiatives while we develop proposals and will be Board be looking to compile responses into a number of cohesive options?

A6. The criteria consultation is a continuum, with the 21st August Q&A/forum forming part of the process. Grouping for pools have yet to be defined, but regional, asset, liability and philosophy bases have been discussed. The Board will have a central role in coordinating responses and analysis to support the proposals and the development of suitable proposals is a challenge for the room.

Q7. I would like to know if there are any particular plans for funds with low cost, outperforming internal investment teams.

A7. As above, the intention is for all LGPS assets to be pooled, there will not be exemptions for any fund. However, outperforming internal investment teams are well placed to work together to lead and influence the pooling proposals.

Q8. Has the option of negotiating an LGPS fee with external managers been considered without the need to pool funds? I understand that some managers are offering this already.

A8. As above, the policy intention would not be met by frameworks and/or procurement initiatives alone. A "keep doing what you're doing", "business as usual" option would not be acceptable to government.

Q9. Can it be confirmed if this issue/consultation includes Scotland or is it purely England & Wales.

A9. The consultation is for England and Wales, and the criteria setting will be carried out by DCLG. The regulations for the LGPS in Scotland are devolved, therefore Scotland is not included.

Q10. Some asset class mandates are restricted by capacity, for example, private equity. Are these sorts of asset class exempt from pooling?

A10. It is the intention that all asset classes would be included in pooling, including alternatives asset classes, property, private equity etc.

Q11. What are the timescales?

A11. Criteria should be available in the autumn, and government will expect a report on how work has moved forward by next March. A 'clear direction of travel' would be useful within the next six months. Proposals are expected to be realised within the lifetime of this parliament. It is recognised that this is a challenge – but Secretary of State has a preference for collaboration over prescription.

Q12. Will financial support be provided to help establish investment pooling infrastructure (i.e. setting up systems, processes and staff etc, not infrastructure as an asset class)?

A12. Funds will be expected to meet the costs of restructuring investments from their own budgets. As mentioned earlier, and in the knowledge that expenses will be considerable, the government is looking at a timescale longer than term of office for any cost savings to fully materialise.

Department for Communities and Local Government

Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies

Consultation response

November 2015
Department for Communities and Local Government

This document/publication is also available on our website at www.gov.uk/dclg

If you have any enquiries regarding this document/publication, complete the form at http://forms.communities.gov.uk/ or write to us at:

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Contents

The consultation

1.1 This paper sets out the Government's response to the consultation, *Opportunities for collaboration, cost savings and efficiency,* which ran from 1 May to 11 July 2014. It outlines the main themes raised by respondents under each question and attempts to capture the wide range of views expressed.

1.2 The consultation set out how the Local Government Pension Scheme (the Scheme) could save up to £660 million a year by investing collaboratively and more efficiently. It sought respondents' views on the proposals for reform and how, if adopted, they might be implemented most effectively.

Background to the consultation

1.3 In 2010, the Government commissioned Lord Hutton to chair the Independent Public Service Pensions Commission to review public service pensions and make recommendations on how they might be made more sustainable and affordable in the long term, while being fair to both taxpayers and public sector workers. Lord Hutton's final report was published on 10 March 2011. The report highlighted the collaborative approach being taken by funds within the Local Government Pension Scheme and recommended that the benefits of co-operative working be investigated further.

1.4 Recognising the scope for potential savings to the Scheme, the Department hosted a round-table event with the Local Government Association to consider these issues in May 2013. The objectives for reform identified at the round-table fed into a call for evidence on the future structure of the Scheme that ran from 21 June to 27 September 2013. This asked respondents to consider how the administration, structure and management of the Scheme might be reformed to reduce fund deficits and improve investment returns, as well as cut investment fees and administration costs, strengthen the availability and quality of in-house resource, and improve the flexibility of investments. A copy of the call for evidence and the Government's response is available at https://www.gov.uk/government/consultations/call-for-evidence-on-the-future-structure-of-the-local-government-pension-scheme.

1.5 The responses were shared with the shadow Scheme Advisory Board, which provided the Minister for Local Government with an analysis of the responses and a number of recommendations. The shadow Board's findings were also published at http://www.lgpsboard.org/index.php/structure-reform/board-analysis-menu.

1.6 The responses to the call for evidence and the recommendations of the shadow Board helped to inform the consultation, *Opportunities for collaboration, cost savings and efficiencies*. In addition, a third piece of analysis was used to shape the proposals, commissioned by the Minister for Local Government and the Minister for the Cabinet Office using the Contestable Policy Fund. Hymans Robertson were chosen to examine three options for reform: creating five to ten merged funds, setting up between five and ten collective investment vehicles (CIVs), or establishing just one collective investment vehicle. This analysis, which identified scope for savings of up to £660 million each year, set out the costs and benefits of each option, the time required to realise any savings, and the practical and legal barriers to implementation. It also included an analysis of Scheme performance over 10 years based on data provided by 98 local government pension schemes to the WM Company Limited. A copy of the Hymans Robertson report is available at https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies.

Summary of proposals

1.7 The consultation, published on 1 May 2014, set out the following package of proposals:

- Establishing collective investment vehicles to provide administering authorities with a mechanism to access economies of scale, helping them to invest more efficiently in listed and alternative assets and to reduce investment costs.
- Significantly reducing investment fees and other costs of investment by using passive management for listed assets, since the aggregate fund performance has been shown to replicate the market.
- Keeping asset allocation with the local fund authorities, and making available more transparent and comparable data to help identify the true cost of investment and drive further efficiencies in the Scheme.
- A proposal not to pursue fund mergers at this time.

1.8 The consultation sought respondents' views on the proposals and how they might be implemented. In particular, interested parties were asked to address the following questions:

Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?

Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

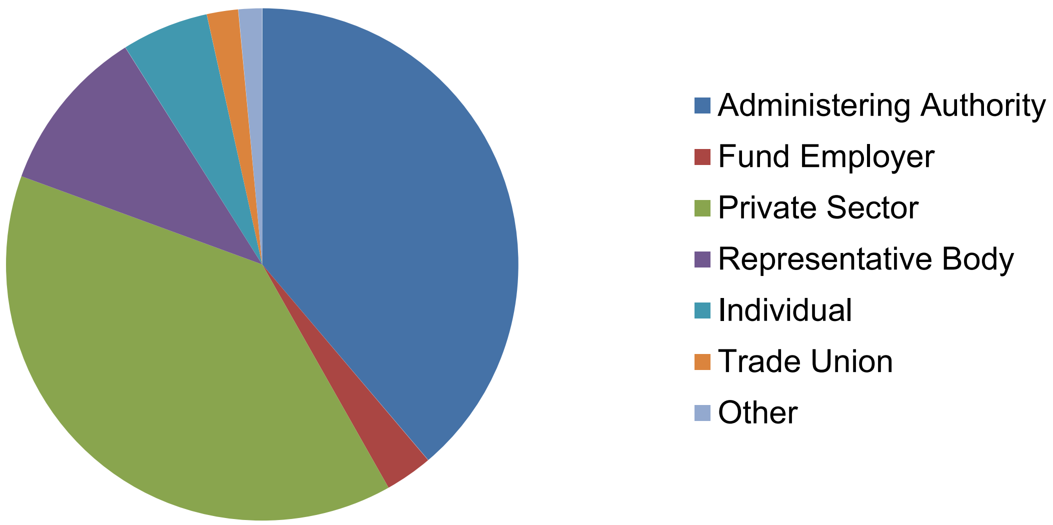
Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

1.9 A summary of the responses received is provided for each question in section four. Several submissions also discussed alternative proposals for reform or ideas for reducing the deficit faced by most administering authorities, since the Scheme as a whole has assets to cover around 79 per cent of its liabilities. An overview of these suggestions is also available in section four.

Summary of responses received

2.1 201 responses to the consultation were received in total, with both the public and private sector well represented. A full list of respondents has been included in Annex A.

Administering authorities	78	Representative bodies[1]	21
Private sector organisations	78	Individuals	11
Fund employers	6	Trade Unions	4
Other	3		



2.2 The majority of consultation responses agreed that using collective investment vehicles would deliver savings for the Local Government Pension Scheme. Similarly, there was a broad acceptance that there was a role for passive management in a balanced portfolio of investments, although most respondents felt strongly that neither proposal should be made compulsory.

2.3 However, respondents often differed when considering the detail of the proposals. For example, a wide range of views were put forward as to where collective investment vehicles might add most value, or how they should be organised.

2.4 It was commonly argued that further work was required to develop the policy, including setting out what a viable collective investment vehicle structure might look like. In addition, some respondents suggested that alternative governance, investment and administration reforms should be considered, in order to improve fund performance or address deficits. However, no overarching deficit reduction proposals were put forward.

[1] *Representative bodies* include lobby groups and *Other* includes civil society organisations.

Government response

3.1 As set out in paragraph 2.1, *Opportunities for collaboration, cost savings and efficiencies* attracted a high level of interest from both the public and private sector, with over 200 responses received. It was clear that a great deal of consideration and effort went into these submissions and we are grateful to the individuals and organisations that provided a response.

3.2 The consultation set out the evidence and rationale for pooling investments through collective investment vehicles and using passive management for listed assets like bonds and equities. It sought to open up for discussion the focus of the reforms and to learn from respondents how the proposals might be best implemented.

3.3 In response to this first issue, the focus of the reforms, respondents were broadly in agreement: Mergers should not be pursued; asset allocation should remain with the administering authorities; and collective investment vehicles, at least in some capacity, offered the opportunity to deliver economies of scale. The Government remains of the view that asset allocation should stay with each of the 90 administering authorities and that savings can be delivered through the use of asset pooling, and in particular collective investment vehicles.

3.4 Respondents offered a wider range of views on the question of implementation. However, two common themes emerged:

- The proposals should not be made compulsory;
- A more detailed proposal is required before any final decisions about implementation can be made.

3.5 The Government recognised that further work was required to develop the policy. Indeed, questions three, four and five of the consultation encouraged respondents to shape the policy and suggest what a detailed package of proposals might look like. Many respondents offered their thoughts in this area, discussing the relative advantages and disadvantages of the different types of collective investment vehicle available, or offering suggestions as to the number of vehicles that might be required and how they should be organised.

3.6 In addition to the responses submitted, the Government commissioned PricewaterhouseCoopers (PwC) to analyse how collective investment vehicles could be best structured in terms of ownership and as legal entities. Their report discussed the different types of collective investment vehicle and concluded that the Authorised Contractual Scheme was likely to be the preferred approach. An Authorised Contractual Scheme is a UK based, tax transparent fund that is regulated by the Financial Conduct Authority and is designed to make it easier for the underlying investors to access the correct rate of tax when buying and selling investments. A copy of PwC's report is available at: https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance.

3.7 Having considered the evidence and analysis of the consultation responses, the Government decided to pursue a localised approach to reform, inviting authorities to determine how best to pool their assets and with whom to work. The following announcement was made at the July Budget 2015:

The Government will work with Local Government Pension Scheme administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The Government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out those detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments.

3.8 Drawing on the consultation responses and discussions with local government and the fund management industry over the summer, the Government has prepared criteria against which the authorities' proposals for pooling will be assessed. Authorities are asked to develop proposals for pooling assets that demonstrate:

- Asset pool(s) that achieve the benefits of scale,
- Strong governance and decision making,
- Reduced costs and excellent value for money, and
- An improved capacity to invest in infrastructure.

3.9 The criteria and supporting guidance have been published and can be found at: https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance.

3.10 A consultation has now been launched on draft regulations that would reform the investment regulations and introduce a power of intervention to allow the Secretary of State to intervene in an authority's investment function should it not bring forward ambitious proposals for pooling. The consultation, Revoking and replacing the Management and Investment of Funds Regulations 2009, is open until 19 February 2016 and available at: https://www.gov.uk/government/consultations/revoking-and-replacing-the-local-government-pension-scheme.

The responses in detail

4.1 This section provides a detailed overview of the consultation responses, with quotations used throughout to illustrate the points raised. It captures the views expressed by respondents, and includes notes to supplement the Government's response.

Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.

4.2 Over two-thirds of the respondents that expressed a clear view in reply to this question agreed that collective investment vehicles would, at least in some respects, help the administering authorities to achieve economies of scale and deliver savings. Although opinions varied as to where pooled vehicles could add most value, there was a broad consensus that participation should be voluntary, with administering authorities able to invest elsewhere as well.

Benefits of collaboration and collective investment vehicles

4.3 The benefits of collective investment vehicles were widely discussed, with many responses focusing on the opportunity that larger pooled funds presented to reduce asset manager fees. Lower administration, commission and custodian fees were highlighted, as well as a likely fall in transaction costs. It was thought that smaller administering authorities in particular might benefit from access to a wider selection of managers, thereby improving diversification.

> The two largest investment management costs for LGPS [the Scheme] are investment manager fees and asset servicing costs. These are both fees typically charged as a basis point fee, with the basis point charge reducing as the size of assets increases. Accordingly, by combining assets together in a CIV, this should result in larger average asset sizes per mandate, and so reduce fees. [1 basis point is equal to 0.01% of assets].
>
> Deloitte

4.4 Some respondents argued that collective investment vehicles could improve governance, as administering authorities would be refocused on setting their investment strategy if they were no longer responsible for manager selection. They were also seen as a means of accessing better advice, as competition amongst suppliers could increase if demand for these skills was concentrated into a few vehicles.

4.5 However, several responses called for alternative means of collaboration to be considered. For example, fee negotiations with asset managers could take place as if the funds had been pooled, but without the formal vehicle structure. Alternatively, greater use of performance related fees could both drive down costs and promote performance; while improving governance arrangements and the skills of pension committees was thought to lead to better manager selection and lower turnover costs.

4.6 A few respondents argued that in-house management should play a stronger role, with existing teams offering shared service arrangements to administering authorities not currently using internal fund management, in order to deliver scale and savings. Joint committees were also suggested, so that better performing administering authorities can support weaker ones.

4.7 Respondents also stressed that existing examples of collaboration, like the National LGPS Procurement Framework, have been shown to save both time and money. Some argued that they might offer the advantages of a pooled fund without the cost of the supporting structure.

> Using good quality frameworks saves significant time and money for LGPS [Scheme] Funds, ensures best practice OJEU compliant procurement and provides access to services with proven track record and expertise.
>
> National LGPS Frameworks

4.8 A few submissions highlighted that the existing investment regulations[2] would need to be changed to facilitate substantial investment in collective investment vehicles. They argued that the regulations currently include limits on investment in certain types of investment vehicles which would need to be removed. This follows wider calls for the investment regulations to be reviewed, which have been considered by the Government.

Limitations of Collective Investment Vehicles

4.9 Around 30 respondents queried whether savings would be delivered, especially for larger funds that were thought to already access diverse investments and low fees. Some felt that governance and accountability might be weakened if performance was reported at the group, rather than fund level. The vehicles were also seen as a potential barrier to responding to individual administering authorities' needs; for example if boutique fund managers were excluded or an environmental, social and corporate governance policy was ignored.

> Due to focus on fees and capacity CIVs may limit the number of managers funds can choose from. This may exclude some of the boutique managers many of whom have been proven to deliver favourable outperformance net of fees.
>
> Cumbria Pension Fund

Making best use of collective investment vehicles

4.10 Although there was strong support for collective investment vehicles, opinion was divided over where they would add most value. Some respondents felt that pooled funds should only be used for unlisted investments like hedge funds and private equity, while others argued they were most useful for listed assets like bonds and equities. A brief summary of the main arguments from the different view points is provided below.

4.11 Around ten percent of respondents giving a clear response to this question saw no role for collective investment vehicles if passive management of bonds and equities was adopted. Many felt that they were already paying low fees for passive management, by

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[2] The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

using either existing pooled funds or in-house teams. For those using a large, passive pool, creating a new vehicle just for the local government pension scheme was seen as unfavourable, as it could increase transaction costs and would not have a track record of delivery.

> For passive investment, the use of a framework agreement that would access the pooled funds of the large passive managers should be considered. An LGPS wide fee arrangement could be negotiated. Such funds have extremely efficient trading operations in place and benefit from strong administration practices, transition management skills and a sound approach to corporate governance.
>
> Tyne and Wear Pension Fund

4.12 In contrast, a few respondents argued that pooled funds would not be suitable for actively managed bonds and equities, as investment managers may restrict access to certain opportunities because they cannot invest a larger volume of assets. Meeting individual administering authorities' needs was also seen as problematic as they may have different investment policies, for example some permit stock lending but not all.

4.13 A further ten percent stressed the benefits of pooled vehicles for illiquid assets like private equity, hedge funds and infrastructure. Some argued that administering authorities newly investing in these asset classes could learn from more experienced ones, as well as reducing costs by sharing expertise and due diligence checks. Smaller administering authorities were also thought to benefit, offering access to these types of investments without needing to use more expensive "fund of funds". Similarly, it was suggested that other administering authorities may be able to more easily to build on existing projects and invest in social infrastructure.

> A CIV or any other pooled vehicle for alternative investments could…achieve sufficient scale of pooled assets to establish investments in social infrastructure such as social housing or residential care homes.
>
> Legal and General Investment Management

4.14 However, others felt that a collective investment vehicle for investments like private equity and infrastructure would be less effective, since mangers already operating at capacity would have little incentive to reduce fees. Similarly, it was argued that better performing managers may not want to risk having such a concentrated client base and so may choose not to participate in a vehicle just for the Local Government Pension Scheme.

Practical constraints

4.15 Respondents also raised a range of practical issues they wished to see addressed:

- How would the range of skills required for the different types of illiquid assets like infrastructure, private equity and hedge funds be accommodated?
- Would the cost and availability of the resources and skills required to run a vehicle for these illiquid assets be prohibitive? Especially for private equity, where specialist managers with local knowledge and established relationships in several countries may be required?

- Was there not still a case for accessing private equity through a fund of funds, if it provided a better way to diversify investments and manage risk, especially where an existing structure has a track record of strong delivery?

> It is important to understand that Fund-of-Funds allow access to specialist investment managers... It could, for example, be argued that an investor like ourselves could build our own private equity portfolio given that we have £100m invested in the asset class. However, it is naïve in the extreme to think that we could build one that is both sufficiently diversified and exposed primarily to “top tier” managers across the World…
>
> Leicestershire Pension Fund

4.16 Several respondents argued that property should not be included in a collective investment vehicle with illiquid assets like infrastructure and hedge funds. The resource required to support investment in property was seen as a significant cost and barrier to its involvement in a new pooled fund. In addition, many highlighted that it would be expensive to move property investments into a different vehicle as stamp duty land tax that would be payable, although respondents differed on the amount it would cost.

> However, if ownership of all the £12.1 billion LGPS [Scheme] property assets were transferred to a new vehicle, Stamp Duty Land Tax alone would amount to £486 million.
>
> Association of Real Estate Funds

4.17 A few responses also stressed that the savings identified by Hymans Robertson as resulting from a collective investment vehicle for pooled assets did not include property, which was categorised separately and in some cases held directly. As such, they argued that the savings available from investing in property through a pooled vehicle have yet to be demonstrated.

Government response

4.18 The Government has reflected on the views received and invited administering authorities to bring forward proposals for pooling their pension scheme assets. In so doing, it will be up to authorities to determine the most suitable mechanism for pooling and the extent to which different investment approaches, such as in-house management, should be used.

4.19 The Government has published a consultation on revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. This proposes to remove the existing limits on investments and instead move towards the prudent person approach to securing a diversified investment strategy that appropriately takes account of risk.

Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?

4.20 There was almost unanimous agreement, amongst those who responded to this question, that asset allocation should remain with the administering authorities. Many felt that this should include implementation style, such as whether to use active or passive management.

Asset allocation should remain with the administering authorities

4.21 Respondents argued that if the liabilities remained with the administering authorities, it was vital that they also kept the means to address them. A locally set investment strategy was seen as essential if an administering authority was to match its investments to its circumstances; including fund maturity, deficit recovery period, cash-flow requirements, the affordability of employer contributions and the desired risk appetite of the administering authority.

4.22 The democratic link to councillors was also emphasised. At present, investment decisions are typically made by councillors through the administering authority's pensions committee. As such, it was argued that those responsible for determining the asset allocation could be held to account directly by council tax payers through local elections.

> The decisions on strategic asset allocation are therefore best taken where those liabilities are best understood and where responsibility lies for the future funding which is at individual Pension Fund level.
>
> An Administering Authority

Some changes could be made

4.23 However, some respondents also called for changes to strengthen local decision making, with high turnover of pension committee membership often cited as an issue. A number of suggestions were made, including more peer-benchmarking to consider risk relative to the administering authority's liabilities and investment strategy, publishing evidence of a timely and credible deficit reduction plan, and allowing larger employers such as district councils a clearer say in how the funds and investments are managed.

4.24 The creation of a permanent, professional investment committee was also put forward. Staffed by officials with some councillor representation, it was suggested that this body could be responsible for day to day decisions like manager selection, with the elected pension committee focusing on the long term funding strategy.

The existing asset allocation process should be reformed

4.25 Respondents did not typically call for centralised asset allocation, although some argued that administering authorities should be required to meet a minimum performance or governance standard, with those falling short obliged to delegate asset allocation to a stronger authority. In addition, a few suggested that asset allocation could be collated amongst administering authorities of a similar size or type. They envisaged delegating the detailed asset allocation, but keeping the strategic decisions about fund objectives and high level asset allocation at a local level. However, views differed as to whether this should be delegated to in-house pension teams who could react quickly to changing market conditions, or centralised through a joint committee to achieve scale and access specialists.

4.26 Merging investment committees or using a Joint Committee structure for a small number of administering authorities was seen as advantageous by some respondents, who felt it would consolidate knowledge and free up staff to monitor fund manager performance. Employers in multiple local government pension schemes were also thought to benefit from this arrangement, as the scale achieved could enable administering authorities to set employer specific investment strategies:

> At present, the majority of Administering Authorities run a single investment strategy with all employers having an equal allocation across the chosen asset classes. Increasing the scale through a Joint Committee allows more potential to run multiple investment strategies which could include a standard allocation plus low and high risk options. Individual employers would then have the choice of allocation to best meet their own circumstances and risk appetite. Increasing scale and running with fewer Committees therefore potentially increases local accountability at employer level, as well as allowing a better match of the liabilities at local employer level with the investment strategy of the fund.
>
> Oxfordshire Pension Fund

Government response

4.27 The Government agrees that strategic asset allocation should remain with the local administering authorities. However, as authorities develop proposals for pooling assets, they will wish to revisit and review their decision making processes. For example, while asset allocation should remain a local decision, manager selection should be undertaken at the pool level to maximise savings.

Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?

How many common investment vehicles should be established?

4.28 Around sixty per cent of respondents expressed a clear view in response to this question, with most suggesting a minimum number of vehicles rather than an exact total. Of those respondents, almost three quarters called for more than two pooled vehicles, with a further fifteen per cent arguing for as much flexibility as possible. A small number of respondents reiterated their view that collective investment vehicles were not needed. They felt that if all of the asset classes required were to be included, it would add complexity and cost to the administration and governance arrangements.

<u>A small number are needed</u>

4.29 Around ten per cent of those who responded to this question argued that a small number of vehicles would be most effective, for example between one and three. Having just one vehicle for passive investments was seen as advantageous as it would maximise the opportunities to match buy and sell transactions within the pool, reducing interaction with the market and therefore investment costs. A more diverse range of vehicles was thought to be necessary for illiquid assets like infrastructure and private equity, since different skills and resources would be required for each of these asset classes. This group also warned that replicating the existing range of asset classes and investment styles would lead to a proliferation of ineffective vehicles.

<u>Several collective investment vehicles are required</u>

4.30 However, most respondents were in favour of several collective investment vehicles being created. They felt that national vehicles may leave administering authorities insufficiently involved in decision making, or that the governance arrangements would become unwieldy if all 90 authorities were involved. Respondents were also concerned that too few vehicles would increase the funds' exposure to risk. For example, capacity constraints could arise if managers were unable to invest large sums effectively; while other investors may try to exploit the Scheme, aware that any passive investments would need to be rebalanced within known index rules.

> However, as noted in the Hymans Robertson report, there are diseconomies of scale above a certain size while a natural ceiling exists for certain asset classes. Capacity concerns may influence the competition in the market if only the largest investment houses can service demand, limiting many of the more niche or boutique managers who arguably over time have outperformed the market and are best placed to add value while also limiting the extent to which downward pressure on fees can be applied.
>
> Wiltshire Pension Fund

4.31 For many, a larger number of vehicles offered better diversification of asset manager and lower risk. A few suggested that between five and eight vehicles would be ideal, with some arguing that competition between vehicles may boost performance.

A balanced approach

4.32 Several respondents argued that it was not possible to comment on the number of vehicles required until further work had been done to establish a preferred governance structure and operating model. Others felt that the appropriate number should emerge from the design process, once an optimal size of pooled fund has been determined.

4.33 Balancing the need for strong governance, local accountability and input, along with the desired economies of scale and effective decision making, was also a common theme. Similarly, many thought it essential to balance the savings that could be achieved through scale, with the choice and flexibility required to meet administering authorities' investment needs.

> It is widely believed that funds can be too large and subject to capacity constraints, while if not large enough, then potential savings will be significantly reduced. Also, if the mix of asset classes are too diversified, savings could be limited, if not diversified enough, exposure to risk is magnified and may offer limited appeal…Governance arrangements will need to represent the best interest of its members; however if every local authority that manages a pension fund is keen on making representation in the running of the CIV, this would slow down the decision making process and make governance arrangements unwieldy. Therefore a compromise will need to be found.
>
> Milton Keynes Council

How should the common investment vehicles be organised?

4.34 A wide range of ways to organise collective investment vehicles were suggested:

- Creating a vehicle for each **asset class**. This approach was especially popular for illiquid assets like infrastructure, hedge funds and private equity, given the different skills sets, fee structures and access routes involved.
- Using **geographic** groupings or existing networks to facilitate the vehicles, as London Councils are currently doing for the London boroughs.
- Basing vehicles on **risk appetite, investment approach or index,** to help administering authorities deliver their investment strategy, or environmental, social and corporate governance policy. For example, one vehicle might offer the FTSE4Good; a second might be focused on delivering liquid returns; and a third on liability matching.

4.35 Some respondents argued that the number and structure of any vehicles should be decided by the administering authorities, perhaps in response to a clear set of objectives for collaboration set out by Government.

> The number and type of collaborative investment vehicles should be limited to provide for the benefits of scale but should be allowed to develop organically and consist of multi asset class structures.
>
> Shadow Scheme Advisory Board

4.36 Finally, several respondents argued that whatever arrangements were put in place, they should offer the flexibility to react to emerging techniques and the changing needs of the authorities. Views were split as to whether this flexibility should extend to competition between vehicles. Some saw this as a means of preventing monopolies, encouraging innovation and driving down costs, while others thought it might lead to short term decision making and unnecessary asset turnover.

Which asset classes?

4.37 Around fifteen per cent of respondents listed the asset classes that they thought should be included. Many set out a wide range, while others called for the current array of Scheme investments to be offered. A few went further, arguing that reducing the choice available could increase risk in the Scheme, as the assets would become more concentrated into certain asset classes or invested with fewer managers.

4.38 A wide range of geographical markets and implementation styles for bonds and equities were requested. For example, the option to manage both actively and passively was often mentioned, with passive management to include approaches such as smart beta, target index approaches and enhanced passive. These tools use index tracking like most passive funds, but allow the investor to set certain parameters under which the fund may deviate from the index like an actively managed investment. A substantial range of bonds and gilts were also referenced, to encompass different redemption periods and varied risk appetites. A few respondents also called for liability matching, although some felt that this, and other means of addressing interest rate and inflation risks, required a tailored approach for each administering authority and so should be organised outside of any collective investment vehicle.

4.39 For investments other than bonds and equities, a similarly broad range was proposed. This included infrastructure, real estate, global and UK property, hedge funds, private equity, private debt, diversified growth funds and absolute returns.

Government response

4.40 The published criteria and guidance for investment reform asks administering authorities to develop proposals for asset pools that meet their needs, including determining how the pools are structured and the asset classes to be offered. However, it is important that authorities develop larger asset pools in order to access the benefits of scale. The criteria therefore set out the Government’s expectation that authorities will develop proposals for no more than six pools, each with at least £25 billion of Scheme assets.

Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

What structure should be used?

4.41 Just under forty per cent of respondents gave a clear view about the legal structure they felt should be adopted, for example a unitised vehicle; a limited liability partnership, or an authorised contractual scheme. Many argued that further analysis was required to determine the most appropriate structure, or commented instead on the characteristics they would like to see included. Of those who did indicate a preferred structure, two thirds were in favour of the Authorised Contractual Scheme, with many pointing to London where work is underway to establish this type of vehicle.

Authorised Contractual Scheme

4.42 An Authorised Contractual Scheme (ACS) is a tax transparent fund based in the UK. Launched by HM Treasury in 2013, it is regulated by the Financial Conduct Authority and designed to make it easier for the underlying investors to access the correct rate of tax when buying and selling investments both in the UK and overseas. It can take different legal forms, operating as a Limited Partnership or as a Qualified Investor Scheme. The relationship between the investors and scheme operator, as well as the use of sub-funds within the vehicle, depends on the legal structure adopted.

4.43 The Authorised Contractual Scheme was the most frequently discussed structure amongst both public and private sector respondents. The London boroughs have chosen to use this model for their collective investment vehicle and many respondents drew on their analysis, highlighting the following benefits:

- Regulation by the Financial Conduct Authority and by UK law,
- The ring-fencing of assets and liabilities, so that investors cannot be called upon to cross-subsidise each other,
- A tax transparent structure enabling administering authorities to access the right rate of withholding tax,
- New rules on stamp duty land tax which is expected to offer further tax benefits, for example, if a particular structure is adopted, transfers between sub-funds would be exempt from that tax.

4.44 Wider benefits were also cited, including the option to have fund managers accountable to joint committees where several administering authorities could be represented; the opportunity to improve the comparability and transparency of fund data; and the potential to use transparent sub-fund performance data to deliver better returns.

> Pooling through an ACS is seen as having particular attractions for pension funds due to its tax treatment, governance structure, and its flexibility when it comes to accessing different asset classes.
>
> Society of London Treasurers

Other options should be considered

4.45 Although the majority focused on the Authorised Contractual Scheme, a few questioned whether it would be the most practical option. For example, the Authorised Contractual Scheme cannot hold units in Unit Linked Life Trusts, which are often used by the administering authorities to access UK Commercial Property or pooled index funds. Similarly, the vehicle was thought to be potentially tax inefficient for property, as transfers into the vehicle would, at the time of the consultation, be subject to stamp duty land tax. A few respondents suggested that if more than one vehicle were to be established, different structures could be used to reflect the varied needs of the distinct asset classes. For example, a limited partnership or closed ended fund might be appropriate for longer term investments that are hard to convert into cash, like infrastructure. Here the lack of easy subscription or redemption of holdings may be beneficial, but for the same reasons, that structure may not be suitable for more liquid asset classes like equity.

> It is, however, important to recognise [that] the current tax legislation result[s] in an ACS structure being potentially attractive for liquid investments such as equity but raises questions around their use for illiquid investments, specifically property if the assets are to be moved in-specie from an existing portfolio into an ACS structure.
>
> Aviva Investors

Further work is needed to determine the most beneficial structure

4.46 A significant proportion of respondents remained undecided about the optimal vehicle structure or felt unable to comment. Many argued that given the complexity of the question, further work was needed to better understand the options before making a decision. For example, they suggested that even if the Authorised Contractual Scheme was chosen for its tax transparency, a further decision about the legal structure would also be needed – should it be a limited partnership or co-ownership scheme; if the latter, should it take the form of a Qualified Investor Scheme or an Undertaking for Collective Investments in Transferable Securities?

4.47 Instead of proposing a specific vehicle, many respondents from this group set out the characteristics they thought should be present. Typically, they recommended a structure that was cost effective and efficient, transparent and flexible. Direct ownership of assets was also preferred, as was a clear performance management system, so that a manager’s contract could be terminated in the event of poor performance.

> We recognise that we are not experts in the legal and regulatory structure of CIVs… However we can comment on the characteristics that we would expect to see in such a CIV:
>
> - Appropriately regulated
> - Direct Ownership of Assets by investors
> - Tax efficiency and transparency
> - Segregation of liability at sub-fund level
> - Cost efficient
> - Flexible (broad range of asset classes and investment strategies)
> - Flexible (allow additional asset classes and strategies to be added)
>
> Cheshire Pension Fund

4.48 A small number of responses questioned whether the Government had the legal powers to create collective investment vehicles or require participation in them. Some also suggested that the procurement processes would also need to be carefully thought through depending on the legal ownership and creation of vehicle.

What governance arrangements should be established?

4.49 The role of the administering authority in a collective investment vehicle featured strongly in the consultation responses. Many argued that since the assets were owned by the local administering authorities, it was vital that they retained influence. Respondents were divided as to how this should be achieved, but most suggested some form of councillor involvement.

4.50 A popular proposal was to establish a joint committee of councillors to act as shareholders of the vehicle's operating company, drawing on the approach being taken by the London boroughs where the administering authorities each have an equal shareholding. However, others felt this would be unwieldy, with too many people involved in decision making and governance. They suggested that representative bodies of Chief Finance Officers, or the administering authorities' nominated councillors, select a few councillors to act on all of their behalf.

4.51 Some respondents also argued that Scheme members or independent professional advisors should play a role in the vehicle's governance structure. The model used by the National Employment Savings Trust (NEST) was put forward. It includes an elected body of trustees, a properly qualified executive team, and formal processes for engagement with members and employers. A few respondents also wanted greater delegation to professional managers to enable them to react to opportunities as they arose, for example, by allowing them to decide how an administering authority's investment portfolio is constructed.

> Such investment offices should be answerable to a governance board or panel representing the participating funds and their membership. Such boards may benefit from the presence of independent experts or advisers (the equivalent of independent trustees within a corporate trustee context).
>
> Insight Investment

4.52 There was an expectation amongst a few respondents that if collective investment vehicles were established, they would be public sector bodies, with in-house asset management where possible, drawing on skills already present within the Scheme. Some queried whether public sector pay constraints would make it difficult to retain good, skilled staff, while others pointed to the administering authorities that already have in-house investment teams.

4.53 A few respondents also questioned whether the collective investment vehicle should be profit making, with the profit returned to the pension funds. They argued that this would develop a culture of appropriate risk taking which would help the administering authorities to compete in markets against private sector organisations.

Establishing a suitable level of fees is a further governance question. Is the CIV to be profit-making, and if so, should it be owned by the LGPS schemes so that any profit is returned to them? If not profit-making, will it be possible to develop an appropriate internal culture of risk-taking when competing in investment markets against private sector operators?

Linchpin IFM

4.54 Finally, it was important to a few respondents that the structure made it possible for the administering authorities to fulfil their environmental, social and corporate governance commitments and strategies. For example, they argued that asset owners should be able to engage directly with the companies they are invested in and vote independently of fund managers, as set out in the UN Principles of Responsible Investment.

Government response

4.55 The Government has invited authorities to determine their own governance structures and approach to asset pools. In December 2014 PricewaterhouseCoopers were commissioned to analyse the different types of collective investment vehicle and legal structures available. To support authorities in the development of their asset pools, the Government has published this analysis, which is provided for information only. It does not represent the view of Government, and authorities should seek their own professional advice as necessary in the development of their asset pools.

4.56 The Government has included a separate criterion on governance to help authorities develop viable asset pools that streamline decision making while maintaining democratic accountability for the scheme. Authorities will need to design a governance structure that provides them with assurance that their investments are being managed appropriately by the pool and in line with their investment strategy, but also ensures that at the pool level, risk is adequately assessed and managed, a long-term view is taken, and a culture of continuous improvement adopted.

4.57 The Government agrees that authorities should act as responsible, long term investors within a pool and be able to give effect to their environmental, social and corporate governance policies. When developing their proposals for pooling, authorities will therefore need to determine how their individual investment policies will be reflected.

Q5. In light of the evidence on the relative costs and benefits of active and passive management, including Hymans Robertson's evidence on aggregate performance, which of the options set out above offers best value for taxpayers, Scheme members and employers?

4.58 There are two main types of investment approach, which can be used individually or in combination. Passive management typically invests assets to mirror a market in order to deliver a return comparable with the overall performance of the market being tracked. An actively managed fund employs a professional fund manager or investment research team to make discretionary investment decisions on its behalf. By using their expertise, it is hoped that active managers will deliver a level of return in excess of the market's performance, although this comes at a much higher cost than passive management and still has the risk of under performing the index.

4.59 Hymans Robertson considered the performance before fees of equities and bonds in aggregate across the Scheme over the 10 years to March 2013. This new analysis, evaluating the authorities' investments as one Scheme, showed that there was no clear evidence that the Scheme as a whole had outperformed the market in the long term. They concluded that listed assets such as bonds and equities could have been managed passively without affecting the Scheme's overall performance.

4.60 The consultation therefore advocated the use of passive management for bonds and equities, setting out four options for implementation which are discussed below. These ranged from making the proposals compulsory, to asking the administering authorities to consider the benefits of passive management in light of the evidence provided.

4.61 Just over three-quarters of respondents clearly stated a preference for one of the options. Almost all, around 97 per cent, favoured proposal three or four: using a "comply or explain" model or allowing administering authorities to evaluate and act on the evidence presented.

Option 1: Funds could be required to move all listed assets into passive management, in order to maximise the savings achieved by the Scheme.

4.62 Although no one suggested that passive management should be made compulsory, several respondents recognised that it had a role to play as part of a balanced portfolio. They saw passive management as a means of achieving greater transparency, lower transaction and governance costs, and reduced manager selection risk.

4.63 Some respondents went further, acknowledging that active management does not always achieve outperformance and so calling for a substantially passive approach. It was argued that this would free up resources to focus on governance and ensure that active managers were only used when the administering authority felt strongly that it would see consistent, positive returns.

4.64 However, none of the submissions voiced support for option one and a few asked whether the Government had the legal authority to require administering authorities to invest in a particular way. Many were concerned that the administering authorities would see lower returns, or called for the risks associated with passive management to be more closely examined. A summary of the issues raised is provided from paragraph 4.76 below.

Option 2: Alternatively, funds could be required to invest a specified percentage of their listed assets passively; or to progressively increase their passive investments.

4.65 Many of the respondents saw this as a variant of option one, as the administering authorities would still be required to invest a proportion of their assets in a particular way. As such, they argued that it was not viable for the same reasons that they felt passive management of listed assets should not be made compulsory.

4.66 A few felt that this option offered a balance between local control and the need to ensure a viable Scheme. They suggested that the level of passive management required could be individually negotiated, with better performing administering authorities given more autonomy and a higher percentage applied to those identified as poor performers.

4.67 Option two was also seen by a few respondents as a means to increase the use of passive management to a level that could allow it to be effectively managed through a collective investment vehicle. This would ensure that the scale needed for a pooled fund was achieved, while still allowing for some use of active management of listed assets.

Option 3: Fund authorities could be required to manage listed assets passively on a "comply or explain" basis.

4.68 The "comply or explain" approach was most popular with respondents, with around half of those who expressed a clear view preferring this option. It was suggested that a "comply or explain" framework might increase the use of passive management, while also improving the accountability and transparency of fund performance. Some felt that it would allow in-house management to continue, while others thought it could lead to better returns, as it may encourage administering authorities to use active management only where they felt strongly that it would add value.

4.69 However, respondents also argued that greater clarity was needed about how this option would work before reaching a conclusion. In particular, they wanted to ensure that the reporting mechanisms would not be too onerous, to understand what the administering authorities would be expected to "comply" with, and any consequences of non-compliance.

4.70 The 2009 Investment Regulations already require administering authorities to publish a Statement of Investment Principles which sets out the investment strategy adopted by that authority. Some respondents argued that the administering authorities already explain their investment approach through this Statement, while others thought that it could be expanded to meet the requirements of a "comply or explain" system.

4.71 A few responses suggested what the administering authorities might be required to "explain", such as the rationale for using active management; the reasons for any underperformance; and the governance processes in place, including the arrangements for the effective monitoring of fund managers. In addition, evidence to demonstrate the appropriate use of passive management and smarter benchmarks was also put forward.

4.72 Alternatively, a “perform or explain” framework was also proposed, focused on returns net of fees. Under this approach, administering authorities would be expected to demonstrate that they had considered the balance between the additional value secured and the fees being paid, when making their investments.

Option 4: Funds could simply be expected to consider the benefits of passively managed listed assets, in the light of the evidence set out in this paper and the Hymans Robertson report.

4.73 Around a third of those who gave a clear view in response to this question felt that the administering authorities should be able to decide the extent to which they used passive management. They argued that since the administering authorities are best placed to formulate the investment strategy, they should also determine how it is implemented, including when to use active management. Indeed, some thought that this option would allow the administering authorities to ensure that the different reasons for making investments were properly reflected, for example to maximise capital growth, support cash-flow requirements or minimise volatility risk.

> …funds increasingly want their managers to achieve a very fund-specific investment profile (return and risk), not just ‘beat the index’. Examples include portfolios with a specific income bias, or risk strategy… or defined (constraints and discretions) set of investment opportunities. There are many examples of perfectly valid implementation styles which are not just about beating the index.
>
> Eric Lambert

4.74 However, some respondents argued that this option would simply maintain the current situation and so not go far enough. They argued that the administering authorities are already expected to consider the advantages of active and passive management when making their investments and the rationale for their approach should be set out in their investment strategy. Despite this, as the evidence in the Hymans Robertson report has shown, the administering authorities have been achieving an aggregate return equivalent to that of passive management, but paying for active. Furthermore, the report indicated that the Scheme as a whole was using less passive management than peer group of large pension funds in the CEM analysis.[3]

Other options to be considered

4.75 Finally, a few responses suggested alternative ways to implement the proposals:

- Administering authorities could be required by law to account transparently for all investment fees, including those paid through management contracts, unitised investment vehicles, or to consultants. This could include an explanation of the value added in comparison to that available from the use of in-house management teams.

[3] Department for Communities and Local Government: Local Government Pension Scheme structure analysis, Hymans Robertson p.14
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307926/Hymans_Robertson_report.pdf

- A cap on active management fees or an overall budget for investment management could be set out, in order to drive down fees and encourage administering authorities only to use active management where they were most confident of securing higher returns.
- The impact of collective investment vehicles on performance could be evaluated before deciding whether to make passive management of listed assets compulsory. It was argued that administering authorities may gain access to better governance and fund managers through the vehicle, helping poorer performing administering authorities to improve so that the Scheme would achieve an aggregate investment return above the passive benchmark. A few responses went further, suggesting that the London collective investment vehicle could be used as a pilot to test the impact of pooling investments on performance.

Passive management should not be made compulsory

4.76 As indicated in paragraph 4.64, while some of the respondents recognised the benefits of passive management, none voiced support for making it compulsory. This section attempts to capture the main reasons put forward for the continued use of some active management, which many felt was important for a balanced investment portfolio.

<u>A role for active management</u>

4.77 Respondents from both the public and private sectors sought to demonstrate how the administering authorities had benefited from active management, citing examples of investments that had delivered a return above the benchmark set. Many were concerned that these higher returns, which they felt might outweigh the potential cost savings, would be lost if the administering authorities were required to move to passive management of bonds and equities.

> A comparison of lost performance vs. reduced investment fees over this period shows that a total passive approach might reduce this annual cost by £20m over 10 years but this has to be offset against our investment outperformance. Over the last 10 years the Fund has achieved +0.5% returns per annum above the benchmark. Given the average value of the Fund during that period our active approach has added at least £75m to the value of the Fund which more than covers the extra active management costs (£20m) over the same period.
>
> Greater Gwent Pension Fund

4.78 Another popular argument was that the reforms should just apply to the poorer performing administering authorities. Those able to evidence the effective use of active management would not be required to invest passively in bonds and equities. It was suggested that this would bring up the overall performance of the Scheme, without penalising those achieving higher returns. It was less clear how the better performing administering authorities would be identified, although there was a broad consensus that evidence of strong governance and performance to date should be considered.

> Of the actively managed equity portfolios, global equity represented by far the greatest proportion of actively managed assets [in London]. Our analysis found that for 2012/13 that in aggregate London Funds would have been £49.4 Million better off had they invested passively – however there were a significant number of funds who were worse off. If only those getting returns lower than the passive benchmark were able to achieve passive returns and those that got superior returns were able to keep those excess returns then London funds would have been £101.3 Million better off.
>
> Society of London Treasurers

4.79 Similarly, some respondents felt that there were some asset classes where active management may add more value, or where passive management might not be suitable. These included less efficient markets such as the emerging markets, more complex asset classes like private equity, and investment strategies that are difficult to replicate using an index, such as a return in excess of a benchmark like LIBOR.[4]

4.80 Most commonly, however, respondents thought that corporate bonds should be managed actively. Some suggested that it was difficult to replicate a corporate bond index passively, so high tracking errors would arise reducing the returns available. Others stressed that because corporate bond indices are based on the value of debt issued, the investors largest holdings would be with the organisations with the most debt. They argued that this increased the chance of a default and investment losses.

4.81 Finally, some suggested the rules of the market and some indices would mean that investment opportunities might missed; for example if the value of the bond was below the threshold for inclusion in most indices. It was also thought that losses would be incurred that could be avoided by active investors:

> Standard credit indices have strict rules regarding the credit ratings of the underlying constituent securities to reflect different levels of credit risk. In particular, investment grade indices stipulate that only bonds rated at or above BBB -/Ba
> the indices. This means that, should an issuer be downgraded to being rated below investment [illegible] out of the index at the end of the month of downgrade, forcing index -track
> distressed prices. Such “fallen angels,” however, often bounce back; losses initially experienced upon, or in the lead -u
> partially recouped in the following months. For the passive investor the initial losses are locked in as the bond falls out of the index and subsequent gains are not captured.
>
> Western Asset Management Company Limited

Risks and issues of passive management

4.82 Some respondents were concerned that compulsory passive management might increase the administering authorities’ exposure to risk. For example, they argued that passive managers are unable to react to changes in the market, or mitigate risks by selecting investments based on value rather than market position. Others argued that

[4] LIBOR is the London Interbank Offered Rate. This is the average interest rate estimated by lending banks in London that the average lending bank would be charged if borrowing from other banks.

since passive funds usually follow the relative value of investments in an index, investments can become concentrated or over-exposed to individual companies.

> When investors buy the S&P 500 [Standard and Poor's] they are expecting allocation to 500 names. In fact, the top 50 weightings (or 10% of the names) make up almost 50% of the index by market cap – there is more stock specific risk than many might expect.
>
> Unigestion (UK) Limited

4.83 The risk that passive management may lead to lower returns or higher costs than expected was also raised. Most passive funds track the index based on market capital weight, the relative values of the organisations within the index. Some respondents argued that since this market capital weighted approach always follows the movements of the markets, passive funds tend to buy shares when they are getting more expensive and sell them as they are losing value. In addition, it was suggested that active managers might be able to exploit the fact that a higher proportion of the market will be passively invested, since its behaviour will be predictable. As such, active managers may be able to increase their profits at the expense of the Scheme.

Environmental, Social and Corporate Governance Policies

4.84 Respondents from the public, private and civil society sectors all highlighted the importance of ensuring that administering authorities could still implement their environmental, social and corporate governance policies. This was thought to be particularly important where an administering authority had signed up to the UN Principles of Responsible Investment. Some responses felt that a passive management approach would prevent the administering authorities from carrying out these policies. For example, an index tracking passive fund could include an organisation that did not meet their environmental standards. Others referenced the Professor Kay Review into the UK Equity Market and Long Term Decision Making,[5] suggesting that the benefits of good stewardship advocated by Professor Kay, such as playing an active role as a shareholder, could be lost if passive management was used.

Government response

4.85 The Government has considered the responses received and arguments put forward surrounding the use of passive management. Recognising the different needs of each authority, the Government has invited authorities to develop their own proposals to pool their assets. In so doing, authorities will need to address the criterion of reduced costs and excellent value for money. This places the emphasis on authorities to transparently assess their investment costs and fees, and to set out the savings they can deliver over the long term as a result of pooling.

4.86 The Government recognises that both active and passive management have a role to play in the Local Government Pension Scheme. However, authorities should only use active fund management where it can be shown to deliver value for money, and authorities should review how fees and net performance in each listed asset class compare to a

[5] https://www.gov.uk/government/consultations/the-kay-review-of-uk-equity-markets-and-long-term-decision-making

passive index. In addition, authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

Alternative proposals for reform, and deficit reduction in particular

4.87 The consultation also asked respondents to put forward their proposals for reducing deficits. Some respondents took the opportunity to stress that the deficits had arisen for a number of complex and varied reasons, such as contribution holidays, low gilt yields and increasing longevity. Others offered alternative governance, investment and administration reforms, intended to improve performance or address deficits.

Improving governance and reporting

4.88 Some respondents felt that improving decision making and governance would lead to higher returns and so help to reduce the deficits. It was argued that decision making would improve with the publication of more data and performance reports, such as:

- Implementing and reporting against the Myners Principles;[6]
- Improving the information provided to beneficiaries, so that they can better understand where the assets are being invested;
- Introducing regulations to require the setting, monitoring and reporting of progress against agreed governance objectives.

4.89 A few submissions also called for greater professionalization of the management of the Scheme, wanting more in-house expertise able to develop and implement investment strategies.

4.90 Alternatively, a small number of respondents advocated an employer focused approach. They proposed establishing administering authorities for larger groups of employers, such as academies or higher education institutes, which may have a common deficit and cash-flow profile. This was thought to offer these employers a greater role in the governance of the Scheme and an investment strategy that better met their circumstances and so was more likely to drive down their proportion of the existing deficit.

Long term focus

4.91 However, some respondents were concerned that a focus on deficit reduction may lead to a short-term view of performance and lower returns. They argued that administering authorities should adopt a longer-term approach, for example reviewing performance annually rather than quarterly, as recommended by Professor Kay in his Review of UK Equity markets and Long-term Decision-making. It was thought that a longer term approach would lead to high investment returns and therefore reduce the deficit.

[6] http://www.thepensionsregulator.gov.uk/docs/igg-myners-principles-update.pdf

It is still the case that a large majority of funds will hold their asset managers to account for quarterly performance, driving short-term behaviour. Hymans Robertson identify the retention of managers for the long-term, “even through inevitable periods of underperformance”, as a key characteristic of the top ten performing funds they looked at. We believe performance and fees should be structured over time-frames that are measures in multiple years, rather than quarters.

Sarasin & Partners LLP

Government response

4.92 The Government agrees that authorities should take a long-term view of their investments. The consultation on revoking and replacing the existing Investment Regulations 2009 proposes to remove the requirement to review managers’ performance quarterly, encouraging a longer-term view. The criteria for reform also make clear that authorities will wish to consider the findings of the Kay Review when developing their proposals, including what governance procedures and mechanisms would be needed to facilitate long term responsible investing and stewardship through a pool.

Annex A: List of respondents

330 Consulting Limited
Adams Street Partners
AGF International Advisers Co. Ltd
AllenbridgeEpic Investment Advisers Limited
AllianceBernstein Limited
Allianz Global Investors
Angela Pober
Aon Hewitt
AquilaHeywood
Association of Investment Companies
Association of Pension Lawyers
Association of Real Estate Funds
Association of School and College Leaders
Aviva Investors
Avon Pension Fund
AXA Investment Managers
Baillie Gifford & Co
Baring Asset Management
London Borough of Barking and Dagenham
Barnett Waddingham LLP
Barry Town Council
Bedfordshire Pension Fund
London Borough of Bexley Pension Fund
Bfinance UK Limited
BlackRock
BNY Mellon
Brent Pension Fund
British Private Equity and Venture Capital Association
British Property Federation and Investment Property Forum
London Borough of Bromley
Buckinghamshire County Council Pension Fund
Cambridgeshire Pension Fund
London Borough of Camden Pension Fund
Capital Dynamics
Capital Group
Cardiff and Vale of Glamorgan Pension Fund
Carmarthenshire County Council
CBRE Capital Advisors Limited
CBRE Global Investors
CFA Society of the UK
Charles Stanley Pan Asset Capital Management Limited
Cheshire Pension Fund
Chris Bilsland
Chartered Institute of Public Finance and Accountancy (CIPFA)
City and Council of Swansea Pension Fund

City of London Corporation
Clerus
Clwyd Pension Fund
Cornwall Pension Fund
Councillor John Fuller
London Borough of Croydon
Cumbria Pension Fund
Debra Hopkins
Deloitte
Derbyshire County Council Pension Fund
Devon County Council Pension Fund
Devon County UNISON
Dorset County Pension Fund
Durham County Council Pension Fund
London Borough of Ealing
East of England LGA
East Riding Pension Fund
East Sussex Pension Fund
London Borough of Enfield
Environment Agency
Eric Lambert
Essex Pension Fund
F&C Investment Business Ltd (Private Equity Funds)
F&C Investment Business Ltd (Sales and Client Relationships)
Fidelity Worldwide Investment
First State Investments
Fred Green
Generation Investment Management LLP
Gloucestershire Pension Fund
GMB
Greater Gwent Pension Fund
Greater Manchester Pension Fund
Gwynedd Pension Fund
London Borough of Hackney
Hampshire County Council
HarbourVest Partners UK Limited
London Borough of Haringey Pension Fund
Henderson Global Investors
Hermes Fund Managers
Hertfordshire County Council
London Borough of Hounslow
Hymans Robertson LLP
Insight Investment
Invesco Perpetual
Investec Asset Management
Investment Management Association
Islington Pension Fund
JLT Employee Benefits
John Raisin Financial Services Limited

Joint response from civil society organisations
Jupiter Asset Management Limited
Kent County Council Pension Fund
London Borough of Lambeth
Lancashire County Pension Fund
Lazard Asset Management - UK
Legal and General Investment Management
Leicestershire County Council Pension Fund
Leslie Robb
Linchpin IFM, now providing advisory services as City Noble Limited
Lincolnshire Pension Fund
Local Government Association
Lombard Odier Asset Management (Europe) Limited
London Councils
London Pension Fund Authority
Longview Partners
Loomis Sayles Investments Limited
M&G Investments
Majedie Asset Management Ltd
Manchester City Council
Mark Solomon
Markham Rae LLP
Mercer Limited
Merseyside Pension Fund
London Borough of Merton
MFS International (UK) Limited
Milton Keynes Council
MSCI
National Association of Pension Funds
National Housing Federation
National LGPS Frameworks
Natixis Global Asset Management (UK) Limited
Neuberger Berman
London Borough of Newham
Newton Investment Management Limited
Nomura Asset Management UK Limited
Norfolk Pension Fund
North Yorkshire Pension Fund
Northamptonshire Pension Fund
Northern Trust
Northumberland County Council Pension Fund
Nottinghamshire Pension Fund
Osborne Clarke
Oxfordshire Pension Fund
Pantheon Ventures (UK) LLP
Partners Group (UK) Limited
Peter Moon
Pictet Asset Management
PIMCO

PricewaterhouseCoopers LLP
Principles for Responsible Investment
Pyrford International Limited
London Borough of Redbridge
Rhondda Cynon Taff Pension Fund
London Borough of Richmond Upon Thames
Rogge Global Partners
Royal Borough of Greenwich Pension Fund
Royal Borough of Kingston Upon Thames Pension Fund
Royal Borough of Windsor and Maidenhead
Royal London Asset Management
Ruffer LLP
Russell Investments
Sarasin & Partners LLP
Schroders
Shadow Scheme Advisory Board
Shropshire County Pension Fund
SKAGEN Funds
Society of County Treasurers
Society of London Treasurers
Society of Pension Consultants
Society of Welsh Treasurers
Somerset County Council Pension Fund
South Yorkshire Pensions Authority
Squire Patton Boggs (UK) LLP
Staffordshire Pension Fund
Stamford Associates Limited
Standard Life Investments
State Street Global Services
Steve Bloundele
Suffolk Pension Fund
Surrey Pension Fund
London Borough of Sutton
Tameside Council
Teesside Pension Fund
Threadneedle Investments
Torfaen County Borough Council
London Borough of Tower Hamlets
Towers Watson
Tri-Borough pension funds (City of Westminster; London Borough of Hammersmith and Fulham; and the Royal Borough of Kensington and Chelsea)
Tyne and Wear Pension Fund
UBS Global Asset Management
UK Sustainable Investment and Finance Association
Unigestion (UK) Limited
UNISON
Unite
Universities & Colleges Employers Association (UCEA)
Vale of Glamorgan Council

London Borough of Waltham Forest
Wandsworth Council
Warwickshire Pension Fund
West Midlands Integrated Passenger Transport Authority
West Midlands Pension Fund
West Sussex County Council Pension Fund
West Yorkshire Pension Fund
Western Asset Management Company Limited
Wiltshire Pension Fund
Worcestershire County Council

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Department for
Communities and
Local Government

Local Government Pension Scheme: Investment Reform Criteria and Guidance

November 2015
Department for Communities and Local Government

This document/publication is also available on our website at www.gov.uk/dclg

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Ministerial Foreword

At the summer Budget 2015, the Chancellor announced our intention to invite administering authorities to bring forward proposals for pooling Local Government Pension Scheme investments, to deliver significantly reduced costs while maintaining overall investment performance.

We have been clear for some time that the existing arrangements for investment by the Local Government Pension Scheme are in need of reform, and the announcement made plain our expectation that authorities would be ambitious when developing their proposals. The publication of these criteria and their supporting guidance marks a significant milestone on the road to reform, placing authorities in a strong position to take the initiative and drive efficiencies in the Scheme, and ultimately deliver savings for local taxpayers.

The Scheme is currently organised through 89 separate local government administering authorities and a closed Environment Agency scheme, which each manage and invest their assets largely independently. Recognising the potential for greater efficiency in this system, the coalition government first began to consider the opportunity for collaboration in 2013 with a call for evidence. Since then, we have been exploring the opportunities to improve; gathering evidence, testing proposals, and listening to the views of administering authorities and the fund management industry.

The Chancellor's announcement draws on this earlier work and in particular the consultation, *Opportunities for collaboration, cost savings and efficiencies,* published in May 2014 by the coalition government. More than 200 consultation responses and papers were received and analysed, leading to the development of a framework for reform that has administering authorities at its centre. The criteria published today make clear the Government's expectation for ambitious proposals for pooling, and invite authorities to lead the design and implementation of their own pools. The criteria have been shaped and informed by earlier consultations, as well as several conversations with administering authorities and the fund management industry which took place over the summer.

Working together, authorities have a real opportunity to realise the benefits of scale that should be available to one of Europe's largest funded pension schemes. The creation of up to six British Wealth Funds, each with at least £25bn of Scheme assets, will not only drive down investment costs but also enable the authorities to develop the capacity and capability to become a world leader in infrastructure investment and help drive growth. I know that many authorities have already started to consider who they will work with and how best to achieve the benefits of scale. These early discussions place those authorities on a strong footing to deliver against our criteria, and I look forward to seeing their proposals develop over the coming months.

Marcus Jones

Criteria

1.1 In the July Budget 2015, the Chancellor announced the Government's intention to work with Local Government Pension Scheme (the Scheme) administering authorities to ensure that they pool investments to significantly reduce costs while maintaining overall investment performance. Authorities are now invited to submit proposals for pooling which the Government will assess against the criteria in this document. The Chancellor has announced that the pools should take the form of up to six British Wealth Funds, each with assets of at least £25bn, which are able to invest in infrastructure and drive local growth.

1.2 The following criteria set out how administering authorities can deliver against the Government's expectations of pooling assets.

1.3 It will be for authorities to suggest how their pooling arrangements will be constituted and will operate. In developing proposals, they should have regard to each of the four criteria, which are designed to be read in conjunction with the supporting guidance that follows. Their submissions should describe:

A. **Asset pool(s) that achieve the benefits of scale:** The 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported. Authorities should explain:

   - The size of their pool(s) once fully operational.
   - In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
   - The type of pool(s) they are participating in, including the legal structure if relevant.
   - How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
   - The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

B. **Strong governance and decision making:** The proposed governance structure for the pools should:

   i. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;

   ii. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability. Authorities should explain:

- The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
- The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
- Decision making procedures at all stages of investment, and the rationale underpinning this.
- The shared objectives for the pool(s), and any policies that are to be agreed between participants.
- The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
- How any environmental, social and corporate governance policies will be handled by the pool(s).
- How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.
- How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
- The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

C. **Reduced costs and excellent value for money:** In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so are rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.

Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

As part of their proposals, authorities should provide:

- A fully transparent assessment of investment costs and fees as at 31 March 2013.
- A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
- A detailed estimate of savings over the next 15 years.

- A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
- A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

D. **An improved capacity to invest in infrastructure:** Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class. Authorities should explain:

- The proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".
- How they might develop or acquire the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or "fund of funds" arrangements.
- The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

Addressing the criteria

Requirements and Timetable

2.1 Authorities are asked to submit their initial proposals to the Government to LGPSReform@communities.gsi.gov.uk by 19 February 2016. Submissions should include a commitment to pooling and a description of their progress towards formalising their arrangements with other authorities. Authorities can choose whether to make individual or joint submissions, or both, at this first stage.

2.2 Refined and completed submissions are expected by 15 July 2016, which fully address the criteria in this document, and provide any further information that would be helpful in evaluating the proposals. At this second stage, the submissions should comprise:

- for each pool, a joint proposal from participating authorities setting out the pooling arrangement in detail. For example, this may cover the governance structures, decision-making processes and implementation timetable; and
- for each authority, an individual return detailing the authority's commitment to, and expectations of, the pool(s). This should include their profile of costs and savings, the transition profile for their assets, and the rationale for any assets they intend to hold outside of the pools in the long term.

Assessing the proposals against criteria

2.3 The Government will continue to engage with authorities as they develop their proposals for pooling assets over the coming months. The initial submissions will be evaluated against the criteria, with feedback provided to highlight areas that may fall outside of the criteria, or where additional evidence may be required.

2.4 Once submitted, the Government will assess the final proposals against the criteria. A brief report will be provided in response, setting out the extent to which the criteria have been met and highlighting any aspects of the guidance that the Government believes have not been adequately addressed. In the first instance, the Government will work with authorities who do not develop sufficiently ambitious proposals to help them deliver a more cost effective approach to investment that draws on the benefits of scale. Where this is not possible, the Government will consider how else it can drive value for money for taxpayers, including through the use of the "backstop" legislation, should this be in place following the outcome of the consultation described below.

Transitional arrangements

2.5 Plans should be made to transfer assets to the pools as soon as practicable. Analysis commissioned by the Government from PricewaterhouseCoopers (PwC) indicates that, even those pooling mechanisms requiring supporting infrastructure, such as collective investment vehicles, could be established within 18 months. It is expected that liquid assets are transferred into the pools over a relatively short timeframe, beginning from April 2018. It is recognised that illiquid assets are likely to transition over a longer period of time. For the avoidance of doubt, investments with high penalty costs for early exit should not be wound up early on account of the pooling arrangements, but should be transferred across as soon as practicable, taking into account value for money considerations. Any assets that are held outside of the pool should be kept under review to ensure that arrangement continues to provide value for money.

2.6 While authorities will need to be mindful of their developing pooled approach, they should continue to manage both their investment strategies and manager appointments as they do now until the new arrangements are in place. In keeping with the investment regulations, they are still responsible for keeping both under regular review.

Support to develop proposals

2.7 To help authorities develop proposals quickly and efficiently, the Government has made available PwC's detailed technical analysis of the different collective investment vehicles and their tax arrangements at: https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance. This paper is provided for information only. It does not represent the view of Government, and authorities should seek professional advice as needed when developing their proposals. Authorities are also strongly encouraged to learn from those who have already begun to develop collective investment vehicles, such as the London Boroughs or Lancashire and the London Pension Fund Authority.

Legislative context

2.8 At the July Budget 2015, the Chancellor also announced the Government's intention to consult on "backstop" legislation that would require those administering authorities who do not come forward with sufficiently ambitious proposals to pool their assets with others. That consultation has now been published and is available on the Government's website at: https://www.gov.uk/government/consultations/revoking-and-replacing-the-local-government-pension-scheme.

2.9 The consultation proposes to introduce a power for the Secretary of State to intervene in the investment function of an administering authority where it has not had sufficient regard to guidance published by the Secretary of State. The intervention should be proportionate and subject to both consultation and review.

2.10 The draft regulations include a provision for the Secretary of State to issue guidance. Subject to the outcome of the consultation, authorities would then need to have regard to that guidance when producing their investment strategy. The Government proposes to issue this document as Secretary of State's guidance if the draft regulations come into effect. The guidance will be kept under review and may be updated, for example if the proposals for pooling that come forward are not sufficiently ambitious.

2.11 The consultation also proposes to replace and update the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 to make significant investment through pooled vehicles possible.

Supporting guidance

3.1 This guidance is to assist authorities in the design of ambitious proposals for pooling investments and to provide ongoing support as they seek to ensure value for money in the long term. It will be kept under review to ensure that it continues to represent best practice.

A. Asset pool(s) that achieve the benefits of scale

Headline criterion: The 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported.

3.2 The consultation, *Opportunities for collaboration, cost savings and efficiencies*, set out strong evidence that demonstrated how using collective investment vehicles and pooling investments can deliver substantial savings for the Local Government Pension Scheme without affecting investment performance. Additional advantages to pooling, which should further reduce costs and improve decision making in the long term, include:

- Increasing the range of asset classes to be invested in directly,
- Strengthening the governance arrangements and in-house expertise available to authorities,
- Improving transparency and long-term stewardship, and
- Facilitating better dissemination of best practice and performance data between authorities.

The case for collective investment

3.3 Published in May 2014, the analysis in the Hymans Robertson report evidenced that using collective investment vehicles could deliver savings. In the case of illiquid assets alone, they found that £240m a year could be saved if investments were channelled through a Scheme wide collective investment vehicle rather than the existing "fund of funds" approach.[1]

3.4 A review of the academic analysis available also supports the case for larger investment pools. For example, Dyck and Pomorski's paper, *Is Bigger Better? Size and performance in pension fund management*, established that larger pension funds were able to operate at lower cost than their smaller counterparts, through a combination of

[1] Hymans Robertson report: *Local Government Pension Scheme structure analysis,* p.3 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307926/Hymans_Robertson_report.pdf

improved negotiating power, greater use of in-house management, and more cost effective access to alternative assets like infrastructure.[2]

> A third to a half of the benefits of size come through cost savings realized by larger plans, primarily via internal management. Up to two thirds of the economies come from substantial gains in both gross and net returns on alternatives.

3.5 A number of respondents to the May 2014 consultation also set out the case for larger funds being able to access lower cost investments. London Councils, for example, estimated that savings of £120m a year could be delivered if £24bn was invested through the London collective investment vehicle (CIV), as a result of reduced investment management fees, improved performance, and enhanced efficiency.

3.6 Formal mechanisms of pooling, such as collective investment vehicles, offer additional benefits to alternative arrangements such as procurement frameworks. For example, Hymans Robertson explained that larger asset pools would increase the opportunities for buy and sell transactions to be carried out within the Scheme, reducing the need to go to the market and so minimising transaction costs. Their analysis found that this could reduce transaction costs, which erode the value of assets invested, by £190m a year.[3]

3.7 Pooling investments will also create an opportunity to improve transparency and information sharing amongst authorities. By having a single entity responsible for negotiating with fund managers and reporting performance, authorities can see what they are paying and generating in returns and how it compares with other authorities. Similarly, Lancashire County Pension Fund and the London Pension Fund Authority, who are developing a pool for assets and liabilities, anticipate economies of scale driving improved performance. They have recently estimated that by pooling they can achieve enhanced investment outcomes of £20-£30m a year from their current levels.[4]

Achieving appropriate scale

3.8 The Government expects all administering authorities to pool their investments to achieve economies of scale and the wider benefits of sharing best practice.

3.9 A move to larger asset pools would also be in keeping with international experience. For example, in Ontario, smaller public sector pension funds are being required to come together to form pools of around $50bn Canadian (approximately £30bn at the time the proposal was made). Similarly, Australian pension funds have been consolidating in recent years, where a formal review in 2010 recommended that each MySuper pension fund be required to consider annually whether they have sufficient scale and membership to continue as a separate pension fund.[5]

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[2] Dyck and Pomorski, *Is bigger better? Size and Performance in Pension Plan Management*, pp.14-15
[3] Hymans Robertson report, pp.14-15
[4] Sir Merrick Cockell, writing in the *Pensions Expert* on 30 September 2015
[5] Government Response to the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Recommendation 1.6,

3.10 The May 2014 consultation sought views on the number of collective investment vehicles to be established. Respondents stressed the importance of balancing the need for scale with local input and practical governance arrangements. It was also argued that while larger asset pools would deliver greater savings, the potential difficulties of successfully investing large volumes of assets in a single asset class, particularly active strategies for listed assets, should also be taken into account. However, while individual managers may restrict the value of assets they are prepared to accept or are able to invest, the selection of a few managers for each asset class would help to mitigate this risk.

3.11 Having reflected on the views expressed in response to the consultation and the experience of pension funds internationally, the Government believes that in almost all cases, fewer, larger assets pools will create the conditions for lower costs and reduce the likelihood of activity being duplicated across the Scheme, for example by minimising pooled vehicle set-up and running costs. It therefore expects authorities to collaborate and invest through no more than six large asset pools, each with at least £25bn of Local Government Pension Scheme assets under management once fully operational.

3.12 However, the Government recognises that there may be a limited number of bespoke circumstances where an alternative arrangement may be more appropriate for a particular asset class or specific investment. As set out below, this may include pooling to invest in illiquid assets like infrastructure, direct holdings in property and locally targeted investments.

Investment in infrastructure and other illiquid or alternative assets

3.13 The Hymans Robertson report highlighted illiquid or alternative assets as an area for significant savings for the Scheme. They found that in 2012-2013, illiquid asset classes like private equity, hedge funds and infrastructure represented just 10% of investments made, but 40% of investment fees. They also demonstrated that changing the way these investments are made, moving away from “fund of funds” to a collective investment vehicle, could save £240m a year.[6]

3.14 The Government expects the pooling of assets to remove some of the obstacles to investing in these asset classes in a cost effective way. A separate criterion has been included on infrastructure, although similar benefits exist for other alternative or illiquid assets, such as private equity, venture capital, debt funds and new forms of alternative business finance. In light of this, authorities should consider how best to access these asset classes in a more cost-effective way. Regionally based pools, such as the London boroughs’ collective investment vehicle, would allow authorities to make best use of existing relationships, while a single national pool for infrastructure or illiquid assets would deliver even greater scale and opportunity for efficiency.

3.15 A considerable shift in asset allocation would be needed to develop a pool of £25bn for investment in infrastructure and other illiquid or alternative assets, such as private equity or venture capital. The Government recognises that such a significant movement in

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http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/government_response/recommendation_response_chapter_1.htm

[6] Hymans Robertson report, p.24

asset allocation is unlikely in the near term. As such, should authorities elect to develop a single asset pool for illiquid investments or infrastructure, the Government recognises that a value of assets under management less than £25bn might be appropriate.

Investments outside of the pools

3.16 The Government's presumption is that all investments should be made through the pool, but we recognise that there may be a limited number of existing investments that might be less suitable to pooled arrangements, such as local initiatives or products tailored to specific liabilities. Authorities may therefore wish to explore whether to retain a small proportion of their existing investments outside of the pool, where this can demonstrate clear value for money. Any exemptions should be minimal and must be set out in the pooling proposal, alongside a supporting rationale.

Property

3.17 As of the 31 March 2014, authorities reported that they were investing around 2.5% of their assets in directly held property, with a further 4.1% invested through property investment vehicles.[7] However, the amount invested varies considerably between authorities, with some targeting investment of around 10% of their assets in direct holdings, for example.

3.18 A number of consultation responses stressed the importance of retaining direct ownership of property outside of any pooled arrangement, a view echoed in our discussions with interested parties over the summer. Directly held property is used by some authorities to match a particular part of an authority's liabilities, or to generate regular income. If these assets were then pooled, while the authority would receive the benefits of the pooled properties, there is a risk that this would not match the liability or cash-flow requirements that had underpinned the decision to invest in a particular property.

3.19 In light of the arguments brought forward by authorities and the fund management industry, the Government is prepared to accept that some existing property assets might be more effectively managed directly and not through a pool at present. However, pools should be used if new allocations are made to property, taking advantage of the opportunity to share the costs associated with the identification and management of suitable investments.

3.20 Where authorities invest more than the reported Scheme average of 2.5% in property directly, they should make this clear in their pooling submission.

Addressing the criterion

3.21 When developing their proposals for pooling, authorities should set out:

- The size of their pool(s) once fully operational.
- In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.

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[7] Scheme Advisory Board, Annual Report http://www.lgpsboard.org/index.php/investment-performance-2014

- The type of pool(s) they are participating in, including the legal structure if relevant.
- How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
- The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

B. Strong governance and decision making

Headline criterion: The proposed governance structure for the pools should:

i. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;

ii. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability.

3.22 A number of consultation responses stressed the importance of establishing strong governance arrangements for pools. Securing the right balance between local input and timely, effective decision making was viewed as essential, but also a significant challenge. The management and governance arrangements of each pool will inevitably be defined by the needs of those participating. However, there are some underlying principles that the Government believes should be incorporated.

Maintaining democratic accountability

3.23 The May 2014 consultation was underpinned by the principle that asset allocation should remain with the administering authorities. Consultation respondents were strongly in favour of retaining local asset allocation, noting that each fund has a unique set of participating employers, liabilities, membership and cash-flow profiles, which need to be addressed by an investment strategy tailored to those particular circumstances.

3.24 Respondents also highlighted the transparency and accountability benefits offered by local asset allocation. If councillors are responsible for setting the investment strategy, then local taxpayers, who in part fund the Scheme through employer contributions, have an opportunity to hold their decisions directly to account through local elections. As one consultation response explained:

> The accountability of Members of the employing authorities playing a part in deciding locally how the assets of the Pension Fund are allocated is important. Employer contributions are paid, in the main, by local council tax payers who in turn vote for their local councillors. Those councillors should have the autonomy to make decisions relating to the investment strategy of that Pension Fund.

3.25 The Government agrees that this democratic link is important to the effective running of the Scheme and should not be wholly removed by the pooling of investments. As set out below, determining the investment strategy and setting the strategic asset allocation should remain with individual authorities. When developing a pool, authorities should ensure that there remains a clear link through the governance structure adopted, between the pool and the pensions committee. For example, this might take the form of a shareholding in the pool for the authority, which is exercised by a member of the pension committee.

Strategic asset allocation

3.26 Establishing the right investment strategy and strategic asset allocation is crucial to optimising performance. It is increasingly accepted that strategic asset allocation is one of the main drivers of investment returns, having far greater an impact than implementation decisions such as manager selection.

3.27 The majority of respondents to the May 2014 consultation supported local asset allocation, but discussions with interested parties over the summer have highlighted a lack of consensus as to what constitutes strategic asset allocation. Definitions have ranged from selecting high level asset classes such as the proportions in bonds, equities and property; to developing a detailed strategy setting out the extent and types of investments in each of the different equity or bond markets.

3.28 Informed by these discussions with fund managers and administering authorities, the Government believes that pension committees should continue to set the balance between investment in bonds and equities, recognising their authority's specific liability and cash-flow forecasts. Beyond this, it will be for each pool to determine which aspects of asset allocation are undertaken by the pool and which by the administering authority, having considered how best to structure decision making in order to deliver value for money. Authorities will need to consider the additional benefits of centralising decision making to better exploit synergies with other participating authorities' allocations and further drive economies of scale. When setting out their asset allocation authorities should be as transparent as possible, for example making clear the underlying asset class sought when using pooled funds.

Effective and timely decision making

3.29 Authorities should draw a distinction between locally setting the strategic asset allocation and centrally determining how that strategy is implemented. The Government expects that implementation of the investment strategy will be delegated to officers or the pool, in order to make the most of the benefits of scale and react efficiently to changing market conditions. As one consultation response suggested:

> We believe that high-level decisions about Fund objectives, strategy and allocation are best made by individual Funds considering their better knowledge of their liabilities, risk and return objectives and cash flow requirements. More detailed asset allocation decisions should however be centralised to achieve better economies of scale, and to allow more specialist management.

3.30 Authorities will need to revisit and review their decision-making processes as part of their move towards pools. For example, in order to maximise savings, manager selection will need to be undertaken at the pool level. Centralising manager selection would allow the pool to rationalise the number of managers used for a particular asset class. The resulting larger mandates should then allow the pool to negotiate lower investment fees. This approach would also give local councillors more time to dedicate to the fundamental issue of setting the overarching strategy.

3.31 A number of authorities have already delegated hiring and dismissing mangers to a sub-committee comprised predominantly of officers. This has allowed these authorities to react more quickly to changes in the market, taking advantage of opportunities as they arise. Similarly, delegating implementation decisions to the pool will allow the participating authorities to benefit not only from more streamlined decision making, but also from effecting those decisions at scale.

3.32 The creation of pools will necessarily lead to a review of decision making within each authority. The Government expects to see greater consolidation where possible. However, as a minimum, we would expect to see the selection of external fund managers and the implementation of the investment strategy to be carried out at the pooled level.

Responsible investment and effective stewardship

3.33 In June 2011, the Government invited Professor John Kay to conduct a review into UK equity markets and long-term decision making. The Kay Review considered how well equity markets were achieving their core purposes: to enhance the performance of UK companies and to enable savers to benefit from the activity of these businesses through returns to direct and indirect ownership of shares in UK companies. The review identified that short-termism is a problem in UK equity markets.[8]

3.34 Professor Kay recommended that Company directors, asset managers and asset holders adopt measures to promote both stewardship and long-term decision making. In particular, he stressed that 'asset managers can contribute more to the performance of British business (and in consequence to overall returns to their savers) through greater involvement with the companies in which they invest.'[9] He concludes that adopting such responsible investment practices will prove beneficial for investors and markets alike.

3.35 In practice, responsible investment could involve making investment decisions based on the long term, as well as playing an active role in corporate governance by exercising shareholder voting rights. Administering authorities will want to consider the findings of the Kay Review when developing their proposals, including what governance procedures and mechanisms would be needed to facilitate long term responsible investing and stewardship through a pool. The UK Stewardship Code, published by the Financial Reporting Council, also provides authorities with guidance on good practice in terms of monitoring, and engaging with, the companies in which they invest.

Enacting an environmental, social and corporate governance policy

3.36 The investment regulations currently require authorities to set out within the statement of investment principles the extent to which social, environmental or corporate governance considerations are taken into account in the selection, retention and realisation of investments. The draft regulations published alongside this document do not propose to amend this principle.

3.37 These policies should be developed in the context of the liability profile of the Scheme, and should enhance the authority's ability to manage down any funding deficit and ensure that pensions can be paid when due. Indeed, environmental, social and

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[8] *The Kay Review of UK Equity Markets and Long-Term Decision Making*, pp. 9-10 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf
[9] The Kay Review, p.12

corporate governance policies provide a useful tool in managing financial risk, as they ensure that the wider risks associated with the viability of an investment are fully recognised.

3.38 As the Law Commission emphasised in its 2014 report on the fiduciary duty of financial intermediaries, the law generally is clear that schemes should consider any factors financially material to the performance of their investments, including social, environmental and corporate governance factors, and over the long-term, dependent on the time horizon over which their liabilities arise.

3.39 The Law Commission also clarified that, although schemes should make the pursuit of a financial return their predominant concern, they may take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.

3.40 The Government's intention is to issue guidance to authorities to clarify that such considerations should not result in policies which pursue municipal boycotts, divestments and sanctions, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government. Investment policies should not be used to give effect to municipal foreign or munitions policies that run contrary to Government policy.

3.41 Authorities will need to determine how their individual investment policies will be reflected in the pool. They should also consider how pooling could facilitate implementation of their environmental, social and corporate governance policy, for example by sharing best practice, collaborating on social investments to reduce cost or diversify risk, or using their scale to improve capability in this area.

Addressing the criterion

3.42 When developing their proposals for pooling, authorities will need to set out:

- The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
- The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
- Decision making procedures at all stages of investment, and the rationale underpinning this.
- The shared objectives for the pool(s), and any policies that are to be agreed between participants.
- The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
- How any ethical, social and corporate governance policies will be handled by the pool(s).
- How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.

- How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.

- The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board’s key performance indicator assessment.

C. Reduced costs and excellent value for money

Headline criterion: In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while maintaining overall investment performance.

Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

3.43 As set out in the July Budget 2015 announcement, the Government wants to see authorities bring forward proposals to reform the way their pension scheme investments are made to deliver long-term savings for local taxpayers. Authorities are invited to consider how they might best deliver value for money, minimising fees while maximising overall investment returns.

Scope for savings

3.44 Pooling investments offers an opportunity to share knowledge and reduce external investment management fees, as the fund manager is able to treat the authorities as a single client. There is already a considerable body of evidence in the public domain to support authorities in developing their proposals for investment reform and this continues to grow with new initiatives emerging from local authorities:

- **Passive management:** Hymans Robertson showed that annual fee savings of £230m could be found by moving from active to passive management of listed assets like bonds and equities, without affecting the Scheme's overall return.[10]
- Their analysis suggested that since passive management typically results in fewer shares being traded, turnover costs, which are a drag on the performance achieved through active management, might be reduced by £190m a year.[11]
- **Collective investment:** Hymans Robertson also demonstrated that £240m a year could be saved by using a collective investment vehicle instead of "fund of funds" for illiquid assets like infrastructure, hedge funds and private equity.[12]
- Similarly, the London Pension Fund Authority has estimated that they have reduced their external manager fees by 75% by bringing equity investments in-house, and hope to expand this considerably as part of their collective investment vehicle with Lancashire County Pension Fund.[13]

[10] Hymans Robertson report, p. 12
[11] Hymans Robertson report, pp. 14-15
[12] Hymans Robertson report, p. 3
[13] Chris Rule, LPFA Chief Investment Officer, reported in *Pension Expert* on 1 October 2015

- **Sharing services and procurement costs:** The National Procurement Framework has also helped authorities to address some of the other costs associated with investment, such as legal and custodian fees, reporting measurable savings of £16m so far.[14]

3.45 As Hymans Robertson's analysis shows, just tackling the use of "fund of funds" for illiquid assets like infrastructure could save around £240m a year, with clear opportunities to go further. It is in this context that the Government is encouraging authorities to bring forward their proposals for collaboration and cost savings. Although a particular savings target has not been set, the Government does expect authorities to be ambitious in their pursuit of economies of scale and value for money.

In-house management

3.46 Some authorities manage all or the majority of their assets internally and so can already show very low management costs. In these cases, a move to a collective investment vehicle with external fund managers is unlikely to deliver cost savings from investment fees alone. However, there are wider benefits of collaboration which authorities with in-house teams should consider when developing their proposals for pooling. A pool of internally managed assets could lead to further reductions in costs, for example by sharing staff, research and due diligence checks; it may improve access to staff with stronger expertise in particular asset classes; and could introduce greater resilience in staff recruitment, retention and succession planning. Alternatively, newly created pools might wish to work with existing in-house teams to build up expertise and take advantage of their lower running costs.

Active and passive management

3.47 The May 2014 consultation considered the use of active and passive management by the Local Government Pension Scheme. Active management attempts to select fund managers who actively choose a portfolio of assets in order to deliver a return against a specific investment target. In practice, this is often used to try and outperform a benchmark, for that class of assets over a specific period. In contrast, passive management tracks a market and aims to deliver a return in line with that market.

3.48 The consultation demonstrated that when considered in aggregate, the Scheme had been achieving a market return over the last ten years in each of the main equity markets. This suggested that collectively the Scheme could have delivered savings by using less costly passive management for listed assets like bonds and equities, without affecting overall performance. While the majority of consultation responses agreed that there was a role for passive management in a balanced portfolio, most also argued that authorities should retain the use of active management where they felt it would deliver higher net returns.

3.49 In response to that consultation, the Government has now invited authorities to bring forward proposals for pooling investments to deliver economies of scale. The extent to which passive management is used will remain a decision for each authority or pool,

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[14] National LGPS Frameworks website, http://www.nationallgpsframeworks.org/national-lgps-frameworks-win-lgc-investment-award

based on their investment strategy, ongoing performance and ability to negotiate lower fees with fund managers. However, in light of the evidence set out in the Hymans Robertson report and the May 2014 consultation, authorities are encouraged to keep their balance of active and passive management under review to ensure they are delivering value for money. For example, should their net returns compare poorly against the index in a particular asset class over the longer term, authorities should consider whether they are still securing value for money for taxpayers and Scheme members.

3.50 When determining how to measure performance, authorities are encouraged to consider setting targets for active managers that are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons.

Improving the transparency of costs

3.51 In addition to the fees paid to asset managers, there are considerable hidden costs of investment that are difficult to identify and so often go unreported by investors. In the case of the Local Government Pension Scheme, Hymans Robertson showed that investment costs in 2012-13 were at least £790m a year, in contrast to the £409m reported by the authorities.[15] Even the £790m understated the total investment costs as it excluded performance fees on alternative assets such as private equity and hedge funds (it included performance fees on traditional assets) and turnover costs (investment performance figures include the impact of turnover costs).

3.52 To really drive savings within the Scheme, it is essential that these hidden costs are better understood and reported as transparently as possible. Although many of these costs are not paid out in cash, they do erode the value of the assets available for investment and so should also be scrutinised and the opportunities for savings explored.

3.53 The Chartered Institute of Public Finance and Accountancy (CIPFA) has already made some changes to their guidance, Accounting for Local Government Pension Scheme management costs 2014, to encourage authorities to explore these costs and report some through a note to the accounts. For example, these include performance fees and management fees on pools deducted at source. Authorities should have regard to this guidance and ensure that they are reporting costs as transparently as possible.

3.54 In addition, the Scheme Advisory Board is commissioning advice to help authorities more accurately assess their transparent and hidden investment costs. Once available, authorities should take full advantage of this analysis when developing their proposals.

Addressing the criterion

3.55 As set out above, there is a clear opportunity for authorities to collaborate to deliver hundreds of millions in savings in the medium term. Although there is no overall savings target for the Scheme, the Government expects authorities to take full advantage of the benefits of pooling to reduce costs while maintaining performance.

[15] Hymans Robertson report, pp.10-11

3.56 To support the delivery of savings authorities bringing forward proposals are asked to set out their current investment costs in detail, and demonstrate how these will be reduced over time and the savings forecast. Where possible, costs should be reported back to 2012-2013 so that any cost reductions already achieved as a result of procurement frameworks and early fee negotiations are transparently captured.

3.57 Authorities are encouraged to provide:

- A fully transparent assessment of investment costs and fees as at 31 March 2013.
- A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
- A detailed estimate of savings over the next 15 years.
- A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
- A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

D. An improved capacity and capability to invest in infrastructure

Headline criterion: Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class.

3.58 Investment in infrastructure is increasingly being seen as a suitable option for pension funds, particularly amongst larger organisations. This may in part be the result of the typically long term nature of these investments, which may offer a useful match to the long term liabilities held by pension funds.

International experience

3.59 Multiple large international pension funds are investing a significant proportion of their assets in infrastructure. A recent OECD report, which analysed a sample of global pension funds as at 2012, showed that some Canadian and Australian funds (with total assets of approximately £35-40bn in 2014 terms) were investing up to 10-15% in this asset class.[16] The report also noted that those funds with the largest infrastructure allocations were investing directly, and that such investment was the result of the build up of sector-specific knowledge, expertise and resources.[17] This experience might be demonstrated through an organisation's ability to manage large projects, as well as the associated risk.

3.60 Figures published by the Scheme Advisory Board for the 2013 Annual Report show that around £550m, or 0.3%, of the Scheme's total assets of £180bn was invested in infrastructure.[18] This falls some way behind other large pension funds that have elected to invest in this area, such as those noted above and the Ontario Teachers Pension Plan which invested 6.1% according to the same 2014 report.

Creating the opportunity

3.61 The Scheme's current structure, where assets are locked into 90 separate funds, reduces scale and makes significant direct infrastructure investment more difficult for administering authorities. As a result, authorities may determine that they are unable to invest in infrastructure, or may invest indirectly, through the "fund of funds" structure. Such arrangements are expensive, as the Hymans Robertson report demonstrated and this paper sets out in paragraph 3.13.

3.62 Developing larger investment pools of at least £25bn will make it easier to develop or acquire improved capacity and capability to invest in infrastructure. In so doing, it should be possible to reduce the costs associated with investment in this area. This is likely to be the case particularly if authorities pool their infrastructure investment nationally, where the

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[16] OECD, *Annual Survey of Large Pension Funds: report on pension funds' long-term investments*, p.32, available at: http://www.oecd.org/daf/fin/private-pensions/LargestPensionFunds2012Survey.pdf
[17] OECD report, p.14
[18] Scheme Advisory Board annual report http://www.lgpsboard.org/index.php/scheme-investments

resultant scale may allow them to buy-in or build-up in-house expertise in relevant areas, such as project and risk management.

3.63 In considering such investment, administering authorities might want to reflect on the wide range of assets that might be explored, such as railway, road or other transport facilities; utilities services like water and gas infrastructure; health, educational, court or prison facilities, and housing supply. Authorities should also examine the benefits of both:

- Greenfield infrastructure – projects involving the construction of brand new infrastructure, such as a new road or motorway junction to unlock a housing development, or the recent investment of £25m by the Greater Manchester Pension Fund to unlock new sites and build 240 houses; and
- Brownfield infrastructure – investing in pre-existing infrastructure projects, such as taking over the running of (or the construction of a new terminal building at) an airport.

3.64 As set out above, investment in infrastructure represents a viable investment for pension funds, offering long term returns to match their liabilities. Authorities will need to make their investments based on an assessment of risk, return and fit with investment strategy. However, the creation of large pools will make greater investment in infrastructure a more realistic prospect, opening up new opportunities to develop or buy-in the capacity and capability required.

3.65 In developing their proposals for pooling, authorities should take the opportunity to review their asset allocation decisions and consider how they can be more ambitious in their infrastructure investment. The Government believes that authorities can play a leading role in UK infrastructure and driving local growth, and encourages authorities to compare themselves against the example set by the leading global pension fund investors in their approach to allocating assets in this area.

Addressing the criterion

3.66 Authorities should identify their current allocation to infrastructure, and consider how the creation of up to six pools might facilitate greater investment in this area. When developing proposals, authorities should explain:

- The proportion of their fund currently allocated to infrastructure, both directly and through fund, or “fund of funds”.
- How they might develop or acquire the capability and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or “fund of funds” arrangements.
- The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

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Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND COMMITTEE**	
MEETING DATE:	**11 December 2015**	**AGENDA ITEM NUMBER**
TITLE:	**MIFID II – Implications for LGPS funds**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Nil		

1 THE ISSUE

1.1 The Markets in Financial Instruments Directive (MIFID II) which comes into effect from 1 January 2017 has he effect on LGPS funds is potentially very significant implications for LGPS funds.

1.2 LGPS funds are currently classified as professional investors under MIFID I. However, under MIFID II, all local authorities will be classified as retail investors. As the pension funds are not a separate legal entity to the local authority, the pension fund will fall under the retail classification. This could severely restrict the investment opportunities available to LGPS funds and could force the sale of assets that are not approved for retail investors.

1.3 The Fund is assessing the risk from MIFID II to its investment strategy. Where necessary to maintain its investment strategy, the Fund will elect to become a professional investor, providing it can satisfy the criteria.

1.4 The report sets out issue in more detail and the actions being taken to manage the risk to the investment portfolio.

2 RECOMMENDATION

That the Committee notes

2.1 **The potential impact of MIFID II on the Fund and the actions being taken to manage the risk to the Fund's investment portfolio**

3 FINANCIAL IMPLICATIONS

3.1 If the Fund is categorised as a retail investor, the Fund may become a forced seller of specific mandates. This could incur significant transaction costs.

4 BACKGROUND TO MIFID II

4.1 The Markets in Financial Instruments Directive (MIFID II) aims to improve the functioning of financial markets, especially over the counter markets, and to strengthen investor protection via more robust restrictions on appropriate investment products and greater disclosure on fees. It is currently being transposed into national law in EU states (led by the FCA in the UK) and the effect on LGPS funds is potentially very significant. MIFID II comes into effect from 1 January 2017.

(***NOTE: at time of drafting this paper, there is pressure on the EU from national regulators and investment managers to delay implementation by a year; they are concerned that the compliance systems required under MIFID II cannot be put in place by January 2017)***.

4.2 LGPS funds are currently classified as professional investors under MIFID I. However, under MIFID II, all local authorities will be classified as retail investors. As the LGPS funds are not a separate legal entity from the local authority, the pension fund will also fall under the retail classification (corporate pension schemes are trust-based schemes where the scheme is a separate legal entity from the sponsoring company). There will be an opportunity for funds to elect for professional investor status. It is thought that the LGPS is the only DB occupational pension fund that will be classified as retail under MIFID II.

4.3 The shift from professional to retail investor classification has serious negative implications for the LGPS funds. Most significantly:

(1) **Forced sale of assets** - If, when the directive comes into force, a fund holds assets outside the scope of those available to retail investors, the manager may force a fund to sell out of the assets. This could be mitigated if the FCA provides a transition period to enable funds to achieve professional status or have a managed sale of the assets.

(2) **Restricted investment opportunities** - Retail investors are prevented from investing in more “complex” investments so this will reduce the investment options available to funds. Under MIFID II some investment managers and advisors (who currently provide services to professional investors) may be less willing to deal with retail investors (due to FCA regulations).

(3) **Increase in costs –** Management costs could increase due to extra costs of compliance and reporting for retail products and if the funds elect for professional status there will be extra compliance costs for both the manager and the funds. Every time a manager goes for a mandate, managers will have to satisfy itself that the fund to whom it is pitching is a professional investor if the product is not retail compliant.

4.4 The initial estimate from the DCLG is that up to 50% of LGPS assets may be affected. These assets could include infrastructure, private equity/debt/real estate, hedge funds and some multi asset funds.

4.5 The LGA are in discussions with the FCA, HMT, DCLG and Investment Management Association to find ways to lessen the impact on LGPS funds. There are significant implications around the potential pooling of LGPS assets and the Treasury’s desire for LGPS funds to invest in infrastructure; both may be more difficult to implement under MIFID II if indeed they can. The process of opting up to professional status is being discussed with the FCA in order that the differences between the LGPS funds and local authorities are recognised or that the opt-up process is made easier for LGPS funds. In addition there are discussions about a period of transition post January 2017 to avoid the forced sale of assets for those funds that have not completed the election process in time.

4.6 This issue links into work being done by the LGPS Scheme Advisory Board about greater separation of LGPS funds from the administering authority.

Elect for Professional Investor status

4.7 Funds will be able to opt up for professional investor status if they meet specific criteria. They will have to demonstrate they meet the criteria to each manager and each manager will have their own process of deciding whether professional status can be granted. Even if professional status is granted, it will not be the same as those classified as professional investors under the regulations and there will be ongoing compliance requirements.

4.8 The criteria includes:

(1) Quantitative - the size of assets, number of transactions in relevant markets over set time periods, length of time the individuals have worked in the financial sector (need to satisfy 2 out of 3).

(2) Qualitative – "an adequate assessment of the expertise, experience and knowledge of the client that gives reasonable assurance, in light of the nature of the transactions or services envisaged that the client is capable of making his own investment decisions and understanding the risks involved."

5 FUND'S RESPONSE

5.1 The risk that arises from MIFID II has been added to the risk register. The risk will be manageable assuming the Fund successfully elects to be a professional investor.

5.2 The Fund is writing to each manager to ascertain whether they will still manage the existing investment mandate if Avon is classified as a retail investor. Some mandates already satisfy the requirements for retail investors so there will not be a need to elect for professional status with these managers.

5.3 Although the manager will carry the regulatory risk of ensuring they do not sell non-retail products to retail investors, it is the funds that have to collate the information to prove that they are professional investors, or elect for professional status. The Fund will prepare the assessment against the criteria and, with particular reference to the qualitative criteria, decide whether any amendment to the current delegations is required to satisfy the criteria.

5.4 The Committee will have a progress update at Committee meetings until the issue is resolved.

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary.

8 CONSULTATION

8.1 N/a

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 Set out in the report.

10 ADVICE SOUGHT

10.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Woodyard, Investments Manager 01225 395306
Background papers	LGA MIFID II Paper – Oct 2015
Please contact the report author if you need to access this report in an alternative format	

Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**11 DECEMBER 2015**
TITLE:	**INTERIM ACTUARIAL VALUATION 2015**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Appendix 1 – Interim Valuation Report 2015**	

1 THE ISSUE

1.1 Local Government Pension Scheme Regulations 2013 require the Fund to carry out an actuarial valuation every three years, the next due as at 31 March 2016. Between these mandatory valuations, the Fund periodically requests interim valuations to assess whether the funding strategy is on track and to begin the discussions with the actuary, committee and employers about the 2016 valuation.

1.2 The Fund commissioned an interim valuation as at 31 August 2015 which provides the current context for the 2016 valuation.

1.3 The interim valuation provides an update as to the current funding level of the Fund. It does not re-calculate contribution rates or deficit payments. **It is important to note that the interim valuation is a snapshot of the funding level at a particular point in time.**

1.4 The Actuary presented the interim valuation report at a Committee workshop on 12 October 2015. The workshop included a training session on valuation methodology and a presentation of the outcome of the interim valuation. The report used at the workshop is in Appendix 1.

2 RECOMMENDATION

That the Avon Pension Fund Committee notes:

2.1 The information set out in the report including the timetable for the 2016 valuation.

3 FINANCIAL IMPLICATIONS

3.1 The actuarial valuation sets the contribution rates and deficits payments required from scheme employers for the three years following the valuation. The Interim valuation provides some insight into how the funding position has progressed against the funding strategy set out at the 2013 valuation.

3.2 It therefore provides an indication of the scale of the potential changes in contributions required at the 2016 valuation which will set the employer contributions from 1 April 2017.

4 THE REPORT

4.1 The Interim Valuation Report from the Actuary is in Appendix 1.

4.2 The interim valuation updates the 2013 valuation using the same membership data and demographic/actuarial assumptions. Actual cashflow data since 2013 is used and the financial assumptions are updated to reflect changes in market values as at 31 August 2015.

4.3 A key assumption which drives the value of the pension Fund liabilities (the future benefit payments) and therefore deficit is the discount rate. This is set by the Actuary to reflect the overall investment return which we expect to achieve on the Fund's assets over the long term with a suitable allowance for prudence. In terms of setting contributions, the relationship of the expected investment return compared to the rate of expected future increases in benefit payments i.e. CPI inflation is critical (in other words we need to reflect the "real" investment return expected on the Fund assets).

4.4 In 2013 the discount rate/investment return assumption was derived as gilts **plus** a fixed asset out performance to arrive at the overall expected return at that time. Since 2013, long term gilt yields have fallen significantly (from 3.2% to 2.5%), whilst the expected real return on the assets held by the Fund has remained broadly constant. Therefore, simply following the same "mathematical" approach from 2013 to derive the discount rate/investment return assumption would result in a lower discount rate and therefore a higher value of the liabilities. Based on initial discussions with the Actuary this would arguably build in too much "prudence" into the funding strategy given the long term objectives of the Fund.

*4.*5 The Actuary has therefore recommended re-expressing the discount rate for the 2016 valuation as the real expected asset return above the CPI baseline assumption. Importantly this discount rate would build in the same level of real return above CPI as that used in 2013 valuation, meaning that there is consistency in the assumed level of asset return and therefore the same level of prudence versus the long term investment strategy expectations.

4.6 The table below sets out the financial data applicable to the 2013 valuation and 2015 interim valuation

	31 March 2013	31 August 2015
Gilt yields	3.2%	2.5%
CPI Inflation	2.6%	2.4%
Discount rate for past service (gilts +1.6%) used in 2013 valuation	**4.8%**	4.1%
Discount rate for past service (CPI +2.2%) used in 2015 interim valuation	4.8%	**4.6%**
Discount rate for future benefits (CPI +3%)	5.6%	5.4%
Deficit	£876m payable over 20 years	£764m payable over 19 years

4.7 In absolute terms the deficit has fallen slightly from £876m in 2013 to £764m in 2015 (the funding level is unchanged at c. 83%). Had the same discount rate based on gilt yields from the 2013 valuation been used, the deficit in 2015 would have widened to £1,181m.

4.8 The narrowing of the deficit is due to the following:

a) Better than expected investment returns

b) An extension of pay restraint by 1 year (into 2019)

c) A reduction in the inflation assumption

The above offset the reduction in the discount rate from 4.8% to 4.6%.

4.9 However, to help keep employer contribution rates affordable, the funding plans in 2013 were adjusted for the improvement in gilt yields post the valuation date. The rise in gilt yields meant the discount rate rose from 4.8% to 5.2%, adjusting the deficit post valuation date to c. £650m. Therefore, the interim valuation indicates slight upward pressure on deficit contributions from those set in 2013.

4.10 The 2015 interim valuation also indicated upward pressure on future service costs particularly for the councils as a result of the 2013 assumption on the level of members taking up the 50/50 option not being borne out in practice. Furthermore, the discount rate applied to the calculation of the future service rate may need to be revisited which may put upwards pressure on contributions although this may be offset by other factors. At the employer level the future service costs are very sensitive to membership profile changes. At this stage there has been no consideration of the member profile changes at a total Fund or individual employer level and this will be taken into account at the 2016 valuation.

4.11 The actuary discussed the interim position in detail at a workshop on 12 October 2015. It was also discussed with employers at the Employers Conference held on 10 November 2015 in order to provide finance managers with a context for 3 year budget planning from April 2016.

5 2016 VALUATION TIMETABLE

5.1 The actuary has set out the indicative timetable for the 2015 valuation on slide 49 of their report (see Appendix 1). The process will be as follows:

a) The actuary and officers will develop the funding strategy during 4Q15/1Q16 and assess the impact of the market derived financial assumptions in April/May. At this stage the membership data as at 31 March 2016 will not have been processed.

b) A Committee workshop will be held in March/April 2016 to introduce the Funding Strategy Statement (FSS). The draft FSS which sets the parameters for the valuation including the actuarial assumptions and the deficit recovery policy will be agreed at the June meeting. The draft FSS will then be circulated to employers for consultation (as required in the regulations).

c) The final Funding Strategy Statement will be agreed at the September Committee meeting following which the individual employer results will be calculated by the actuary and disseminated to employers.

d) 2016 valuation report to be presented at December committee meeting.

6 RISK MANAGEMENT

6.1 The funding strategy is key to ensuring pension liabilities can be met in the future and therefore the strategy must be regularly monitored so that the Fund and employers are aware as to whether the current funding level deviates from the long term funding plan and the scale of any shortfall / surplus. Such information can assist employers in planning their medium term budgets and assist the Fund officers in managing those employers that pose a greater financial risk to the Fund.

7 EQUALITIES

7.1 An Equalities Impact Assessment has not been completed as the report is for information only.

8 CONSULTATION

8.1 N/a

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 N/a

10 ADVICE SOUGHT

10.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Woodyard, Investments Manager; 01225 395306
Background papers	
Please contact the report author if you need to access this report in an alternative format	

AVON PENSION FUND

2016 ACTUARIAL VALUATION

– TRAINING AND INTERIM FUNDING REVIEW

12 October 2015

Paul Middleman FIA

Leanne Johnston FIA

MAKE TOMORROW, TODAY MERCER

AGENDA

PART 1 – ACTUARIAL VALUATION TRAINING

- Background
- Purpose of an Actuarial Valuation
- Actuarial Assumptions and Liability Calculations
  - Inflation
  - Salary Growth
  - Discount Rate
  - Demographic Assumptions
- Funding Strategy
- Scheme Employers

PART 2 – FUNDING REVIEW AND PLANNING FOR 2016 ACTUARIAL VALUATION

- Recap – 2013 Valuation and Funding Strategy
- 2015 Interim Review
- 2016 Actuarial Valuation – issues to consider and next steps

BACKGROUND
FUNDING CHALLENGES

AUSTERITY AND SECTOR CHANGES

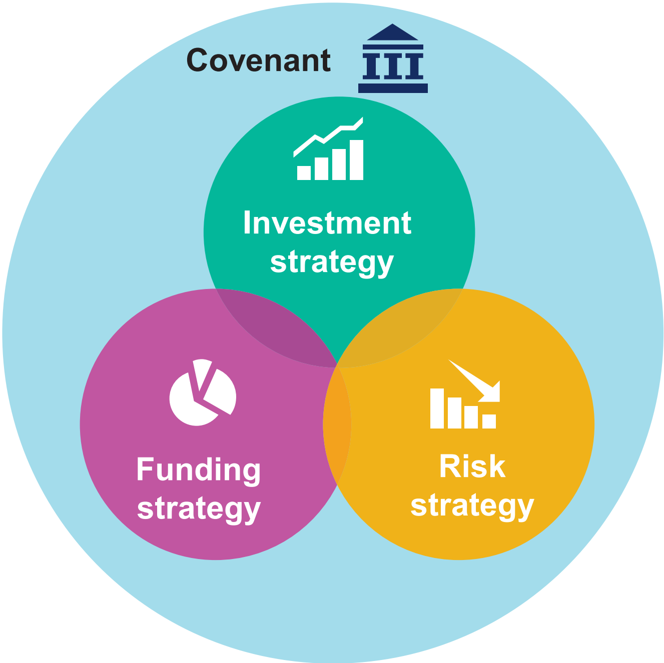
CHANGING MATURITY/ EMPLOYER NUMBERS

GREATER NATIONAL SCRUTINY

NATIONAL BENCHMARKING

ASSET POOLING

EVOLVING RISK MANAGEMENT POLICIES



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STRONG, CLEAR ADVICE AND GOVERNANCE WILL BE KEY

BACKGROUND

FINANCIALS – INDIVIDUAL COUNCILS?

UPWARD COST PRESSURES

2011 2014 2017?

CONTRIBUTION RATES

% OF MEMBERSHIP PAYROLL INCREASING

% OF COUNCIL BUDGET INCREASING

DEFICITS

BUDGET CUTS

AFFORDABILITY WILL BE KEY

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PURPOSE OF AN ACTUARIAL VALUATION

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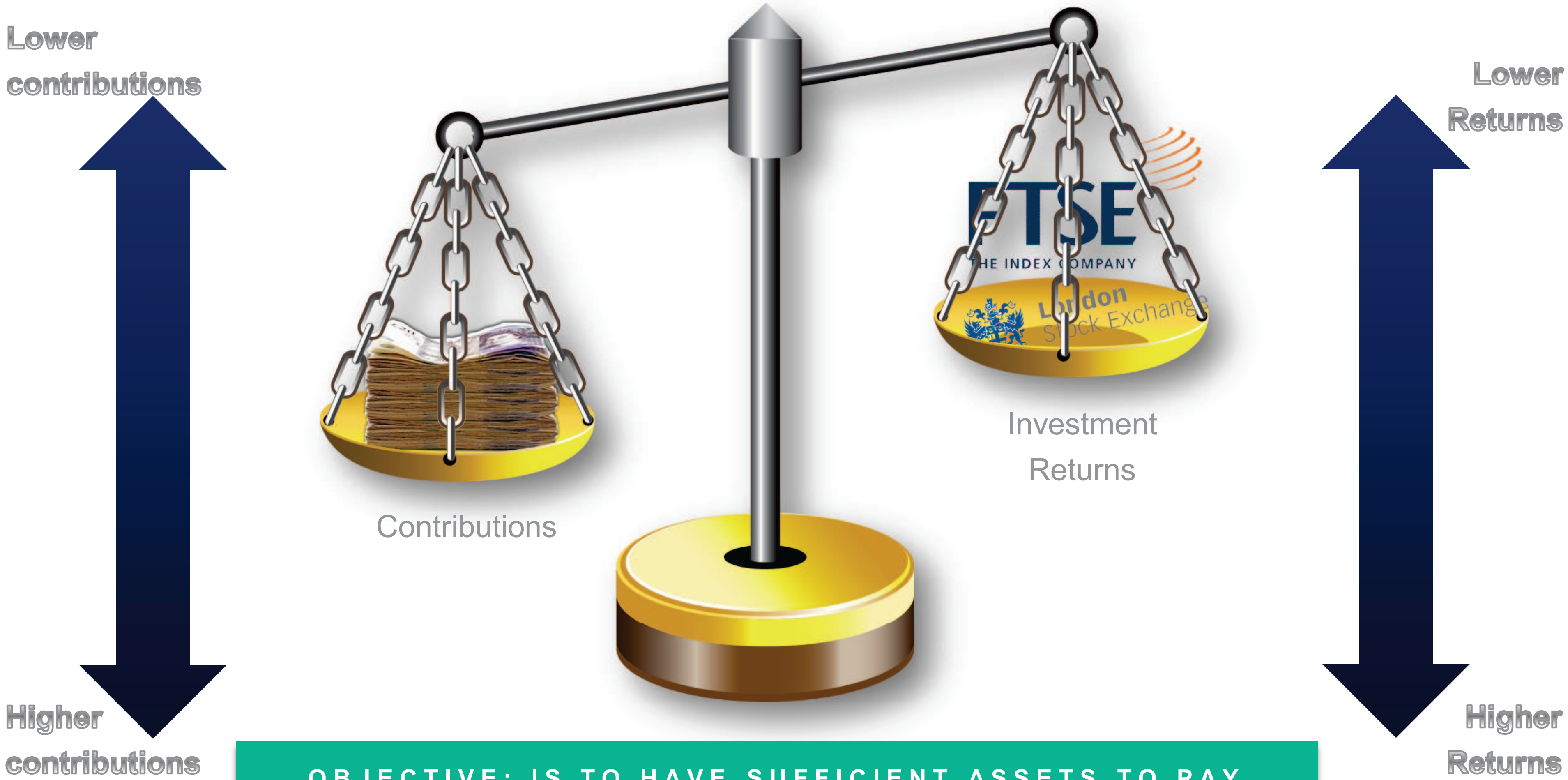
PURPOSE OF AN ACTUARIAL VALUATION
FINANCING THE BENEFITS



OBJECTIVE: IS TO HAVE SUFFICIENT ASSETS TO PAY BENEFITS AS AND WHEN THEY FALL DUE.

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THE FUND'S RETURNS VS CPI

- Broadly speaking, there are two measures in which the Fund's returns need to "beat" CPI to reduce long term costs and therefore contribution requirements:

Long term CPI expectations

- Impacts the value placed on the Fund's liabilities.
- Drives contribution rates and the amount the Fund needs to hold in reserves as part of the long term funding arrangements.
- The Fund requires long term investment returns in excess of CPI

Short term (year-on-year) CPI changes

- Impacts the increase to members' pensions each year.
- There will inevitably be short term fluctuations between movements in CPI and the Fund's short term asset returns.

WHY DO A VALUATION?

Has the Fund got enough assets to cover expected benefits built up to date

How much will the Employers have to pay to for benefits earned in the future?

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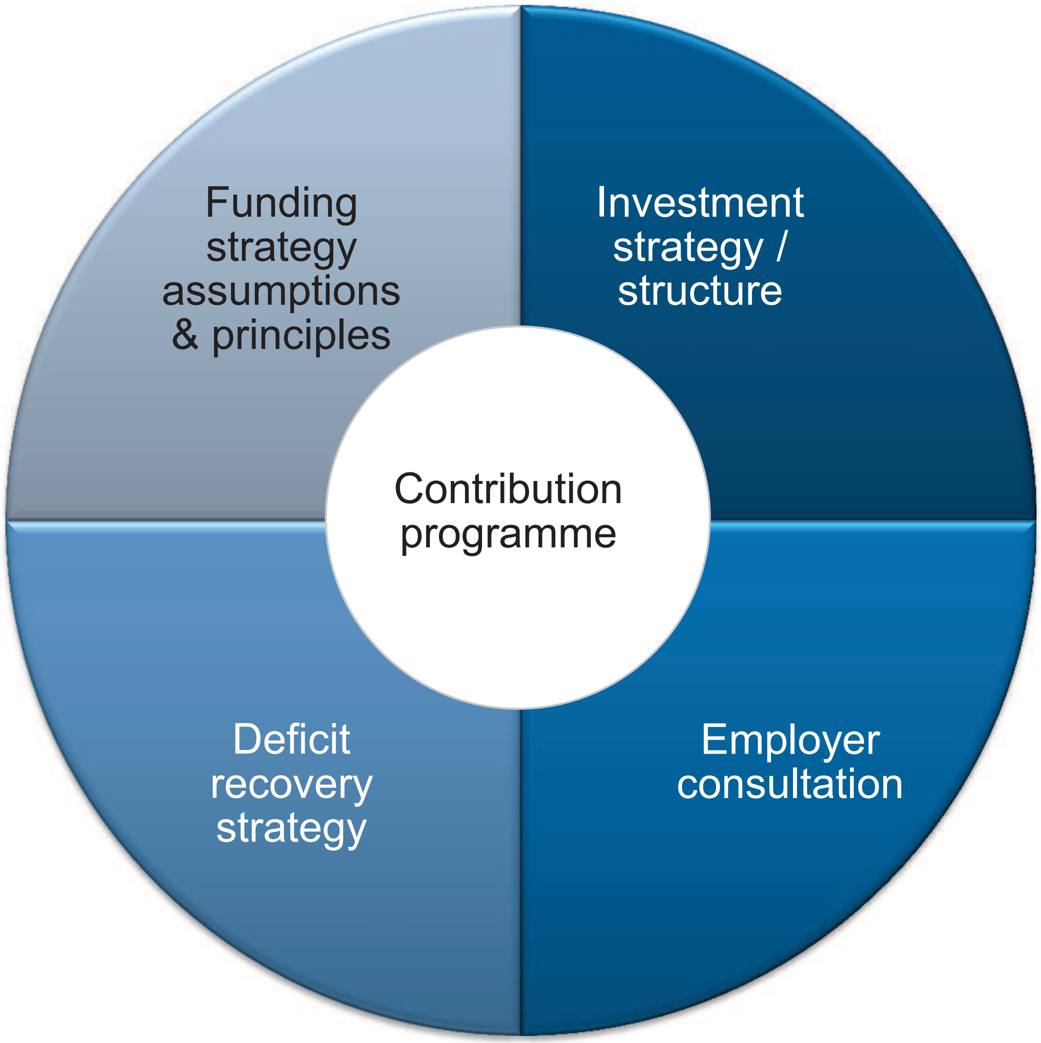
PURPOSE OF AN ACTUARIAL VALUATION
REVIEW OF CONTRIBUTIONS



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THE LGPS FUNDING REGIME - KEY GOVERNANCE DOCUMENTS

Overall financial position	Appropriate contributions	Communication with Employers/ members
Funding Strategy Statement	Rates and Adjustments Certificate	FSS/ Valuation report
Valuation report	Recovery plan	Actuarial Statement

The liabilities are an estimate of the cost of providing the benefits built up by members to the valuation date based on prudent assumption as required by the Regulations and guidance.

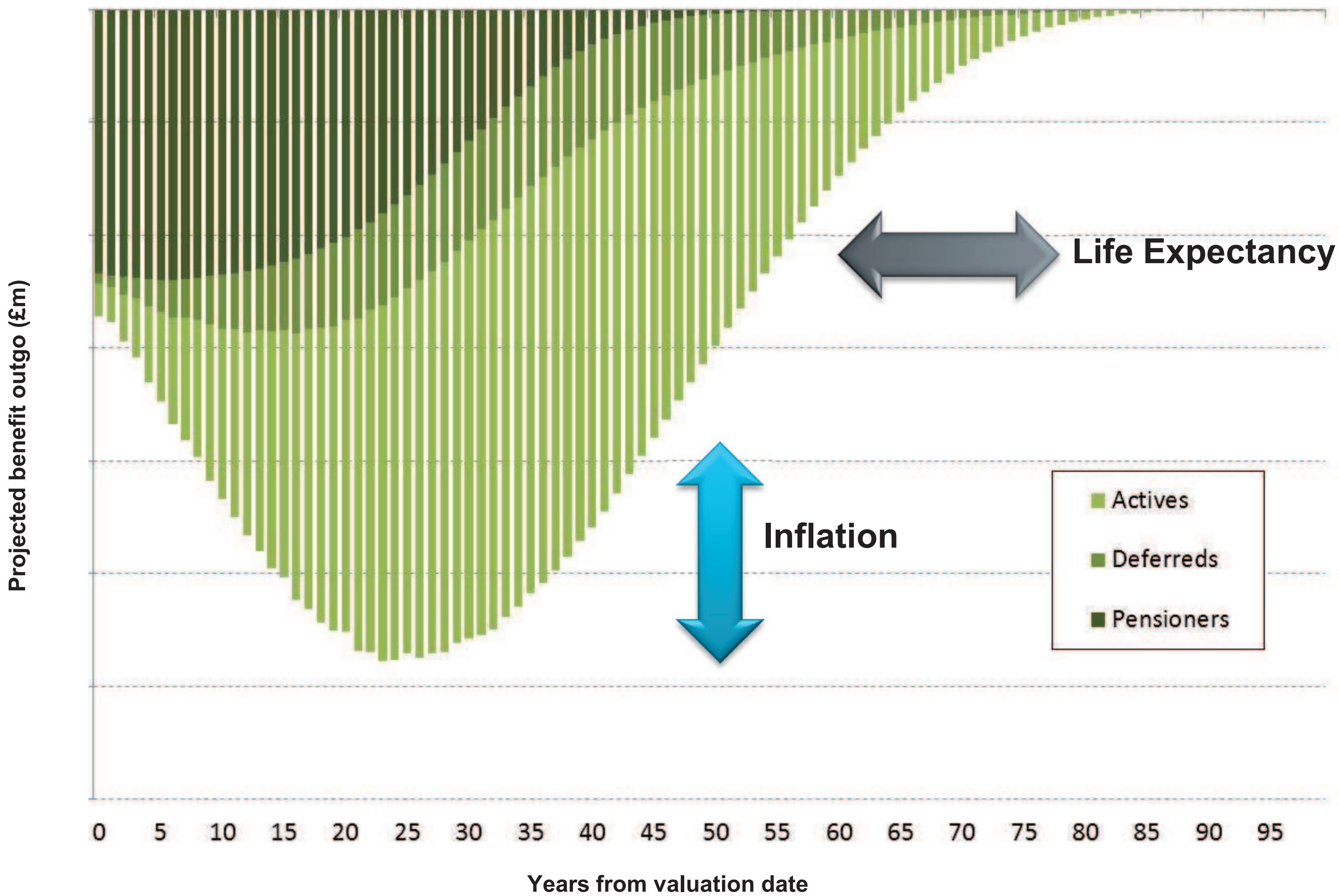
ACTUARIAL ASSUMPTIONS AND LIABILITY CALCULATIONS

BENEFITS BEING VALUED

Benefit changes from 1 April 2014

Pre 2014 benefits	Post 2014 benefits
Normal retirement age 65	Normal retirement age SPA
Mix of $1/60^{ths}$ and $1/80^{ths}$, $3/80^{ths}$ Final Salary	49ths CARE Scheme plus 50:50 option
Pay excl. overtime	Pay incl. overtime
Rule of 85 protections	Further protections and underpins

FUNDING – IT IS ALL ABOUT BENEFIT CASH FLOWS



PAST SERVICE BENEFITS

Contribution impact

Deficit spread over agreed “Recovery Period”

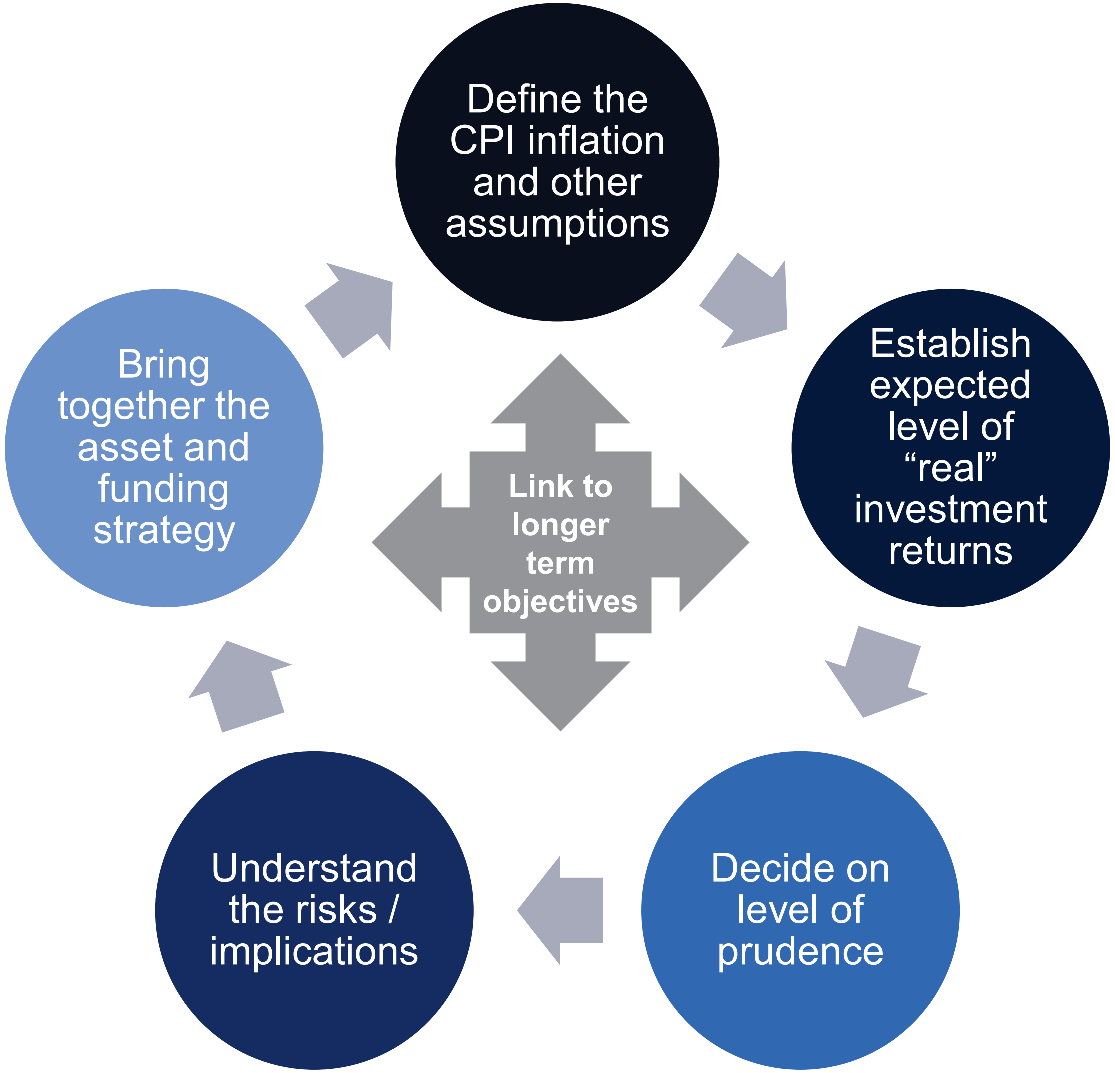
FUTURE SERVICE BENEFITS

Contribution impact

Cost of 1 year’s service

“Future service contribution rate”

PRINCIPLES OF METHODOLOGY



ASSUMPTIONS AND LIABILITY CALCULATIONS
PRUDENCE - DIFFERENT POINTS OF VIEW?

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CHANGING THE ASSUMPTIONS

Actual cost of benefits will not be known until after all benefits paid

Assumptions estimate this cost, but do not change the actual cost

Changing assumptions

↓

Changes the estimate

FINANCIAL ASSUMPTIONS

ASSUMPTIONS IN DETAIL
INFLATION RATE – OUR APPROACH

Comments

- **Market RPI inflation : average derived from market implied projection of year on year RPI inflation based on Government Bonds**
- **Deduction made for any adjustment made to market rates and the difference between RPI and CPI indices**
- **Typical deduction 1-1.3%. 2013 valuation deduction was 1% p.a.**

ASSUMPTIONS IN DETAIL
PAY INCREASE RATE – PRE 2014 BENEFITS

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Comments

- **Real pay growth includes pay increments**
- **Long term real pay growth assumption of 1.5% pa BUT**
- **We should allow for known short term adjustments eg. allow for continuing public sector pay restraint e.g. 2015 Budget announced further restraint of 1% for 4 years.**
- **Also consider building in employer specific adjustments.**

ASSUMPTIONS IN DETAIL
DISCOUNT RATE/ASSET RETURNS

Comments
• Discount Rate/Asset Return built up from expectations on different asset classes held • Expected Real Return: Derive as the real return above CPI inflation based on long term strategic goals • Allow for long term strategic goals and prudence in setting the discount rate.

DISCOUNT RATE/ASSET RETURN
LEVEL OF PRUDENCE- "HURDLE" RATE

National Benchmark discount rate assumption
CPI + 3.0%

EXPECTED RETURNS ABOVE CPI

CPI + 1-1.5%
Example
lower return
High probability of success
(2 in 3 chance)

CPI + 2.2%
2013 discount rate

CPI + 3-4%
Example 50% chance of success
(1 in 2 chance)

Best estimate

Margin for prudence

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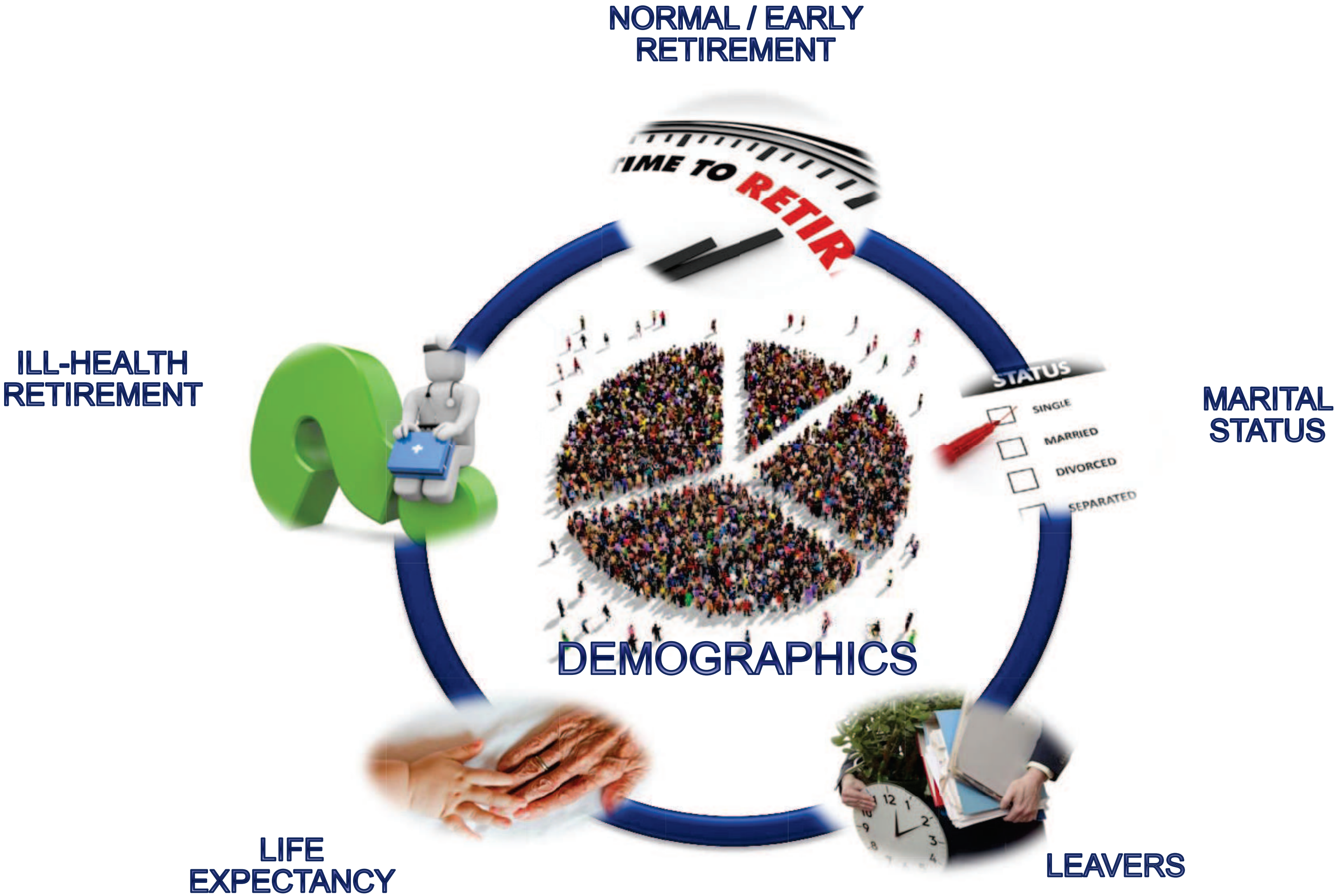
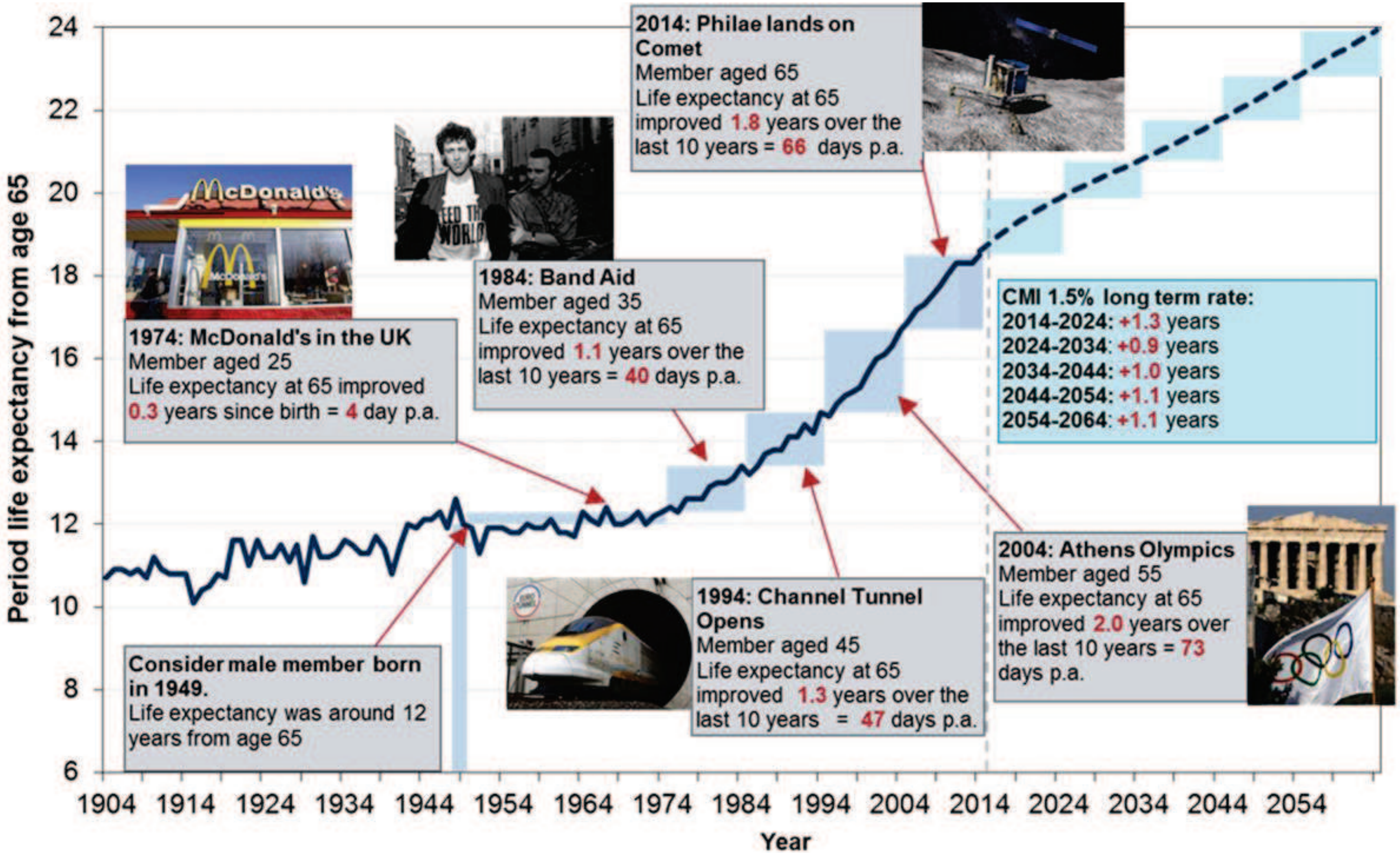
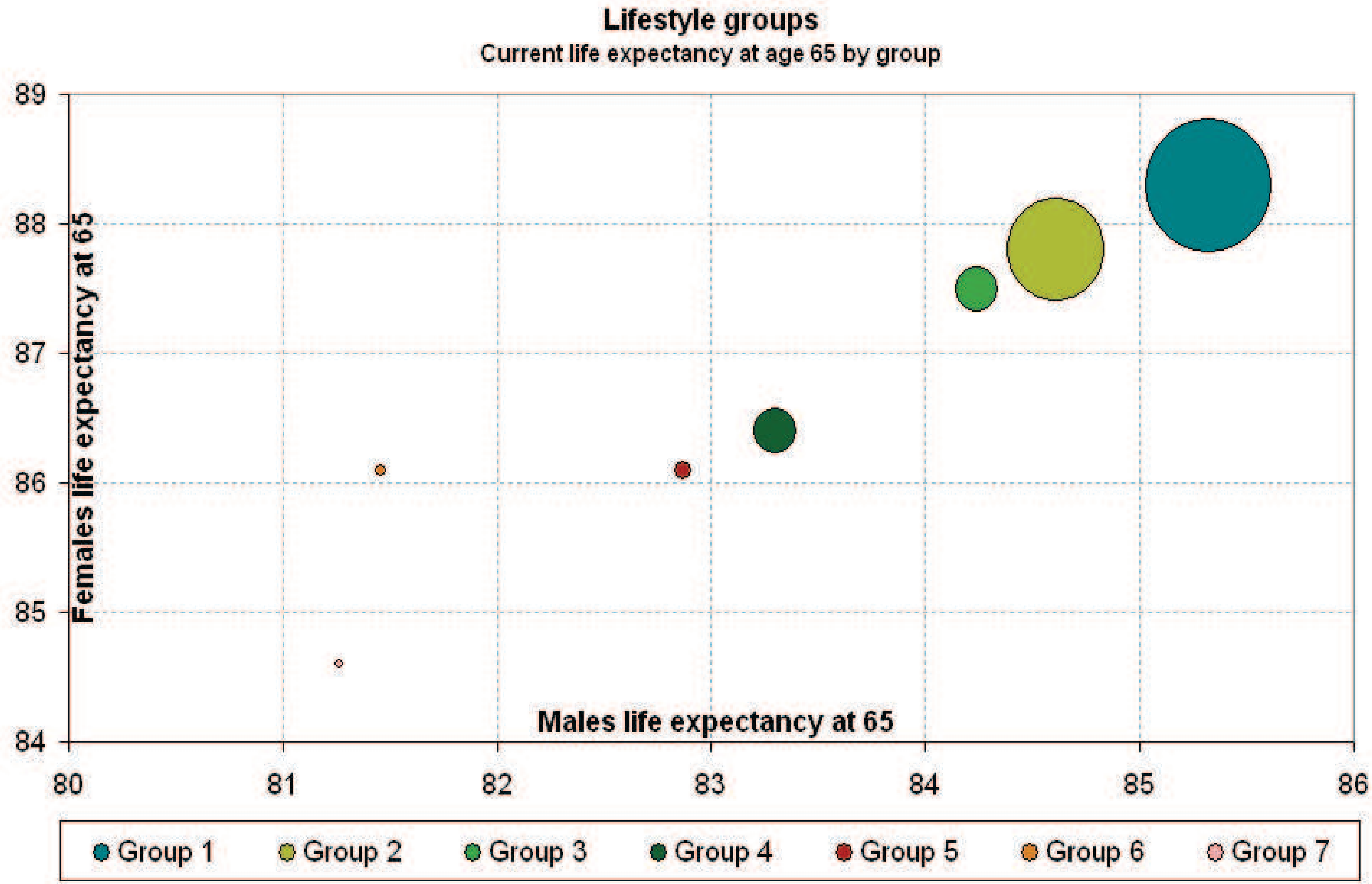
ASSUMPTIONS AND LIABILITY CALCULATIONS
DEMOGRAPHIC ASSUMPTIONS



PEOPLE ARE LIVING LONGER
PAST IMPROVEMENTS (MALES AGE 65)



ASSUMPTIONS AND LIABILITY CALCULATIONS
MORTALITY – FUND SPECIFIC POSTCODE ANALYSIS



There are around 1.8 million distinct postcodes in use in the United Kingdom, resulting in an average of around 15 houses per postcode.

LIFE EXPECTANCY

SOUTH WEST REGION VS APF MEMBERSHIP

	Males		Females	
	Life expectancy at age 65	Rank in England and Wales	Life expectancy at age 65	Rank in England and Wales
Bath and North East Somerset UA	**19.6**	**69**	**21.9**	**90**
Bournemouth UA	18.6	196	21.0	206
Bristol, City of UA	**17.9**	**276**	**20.9**	**226**
Cornwall UA	18.9	163	21.3	167
North Somerset UA	**19.3**	**122**	**21.5**	**147**
Plymouth UA	18.2	239	20.6	259
Poole UA	19.4	84	21.8	110
South Gloucestershire UA	**19.6**	**61**	**22.0**	**78**
Swindon UA	18.4	224	20.8	229
Torbay UA	19.0	155	21.1	200
Wiltshire UA	19.5	81	21.8	112
East Devon	20.0	26	22.1	68
Exeter	18.5	207	22.2	60
Mid Devon	19.9	36	23.0	12
North Devon	19.2	133	21.3	174
South Hams	20.0	29	22.5	34
Teignbridge	19.0	158	22.1	67
Torridge	19.0	151	21.2	180
West Devon	19.2	130	21.8	107
Christchurch	20.6	10	23.4	7
East Dorset	20.8	5	23.5	4
North Dorset	19.9	35	23.1	11
Purbeck	20.1	24	22.8	21
West Dorset	19.9	41	22.3	49
Weymouth and Portland	19.2	136	21.4	157
Cheltenham	19.4	87	22.0	77
Cotswold	20.0	27	22.8	19
Forest of Dean	18.5	213	21.5	148
Gloucester	18.2	246	21.2	179
Stroud	18.9	173	20.8	238
Tewkesbury	18.8	174	22.2	66
Mendip	19.4	95	22.0	74
Sedgemoor	19.5	76	22.1	72
South Somerset	19.8	44	22.2	63
Taunton Deane	19.2	131	21.2	182
West Somerset	19.4	92	22.8	20

Source: Office of National Statistics for years 2011-13

Mortality assumptions adopted for the 2013 actuarial valuation result in life expectancies of 23.2 years for males and 25.7 for females

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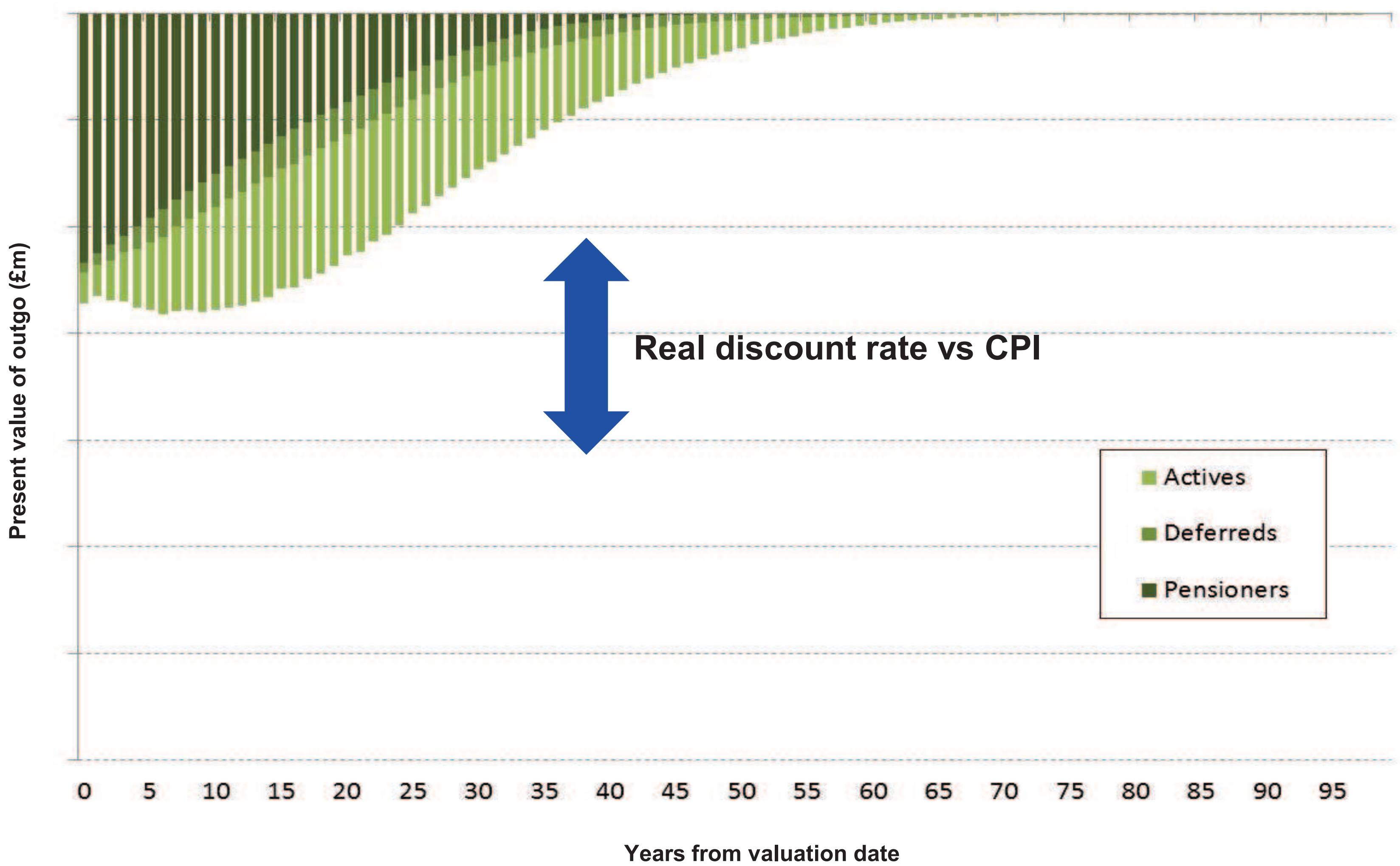
ASSUMPTIONS AND LIABILITY CALCULATIONS
BASIC PRINCIPLES

Benefit formula X Probability of benefit payment arising X CPI increases of date of payment X Cost of providing pension

Discounted back to valuation date

Summed over **ALL** benefits and **ALL** existing and former members and dependants

LIABILITY CALCULATION
DISCOUNTED VALUE



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FUNDING STRATEGY

What is the Funding Strategy?

Reg. 62(6)(b) "The actuary must have regard .... to the desirability of maintaining as nearly a ***constant common rate*** as possible".

Reg. 62(6)(d) "The actuary must have regard to the requirement to..... to ***secure the solvency of the Fund*** and the ***long term cost efficiency**** of the Scheme…"

* New from 2016 valuation

REQUIREMENTS AND OBJECTIVES

DCLG

"Support regulatory requirement to maintain constant employer contribution rates"

Encourage administering authorities to take a prudent longer-term view of their liabilities"

Clear and transparent strategy to meet employers' pension liabilities

- Support stability in contribution rates *as far as possible*
- Prudent approach in funding the liabilities

Purpose of the FSS

EMPLOYER CONSULTATION

All Fund employers should be consulted.

Process for consultation will be decided by the Administering Authority.

Consideration must be given to employers' views.

But ....

Ultimate responsibility rests with the Administering Authority.

FUNDING STRATEGY AND CONTRIBUTION REQUIREMENTS
EXAMPLE RECOVERY PERIOD

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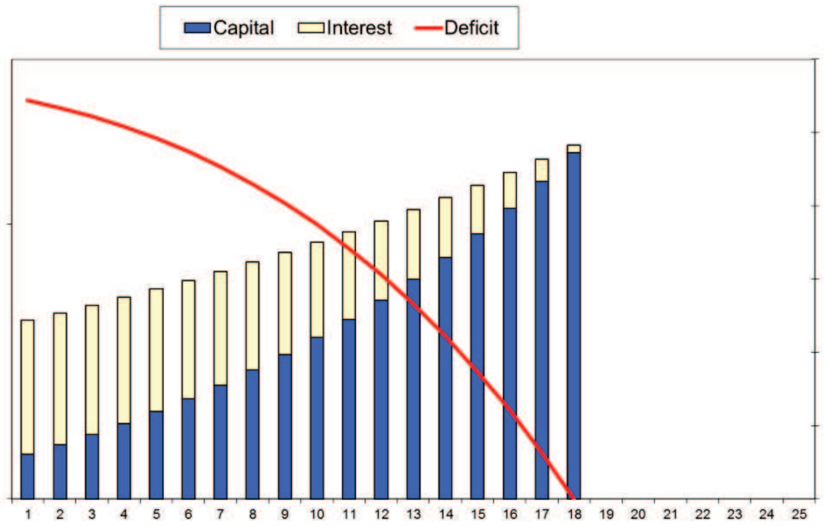
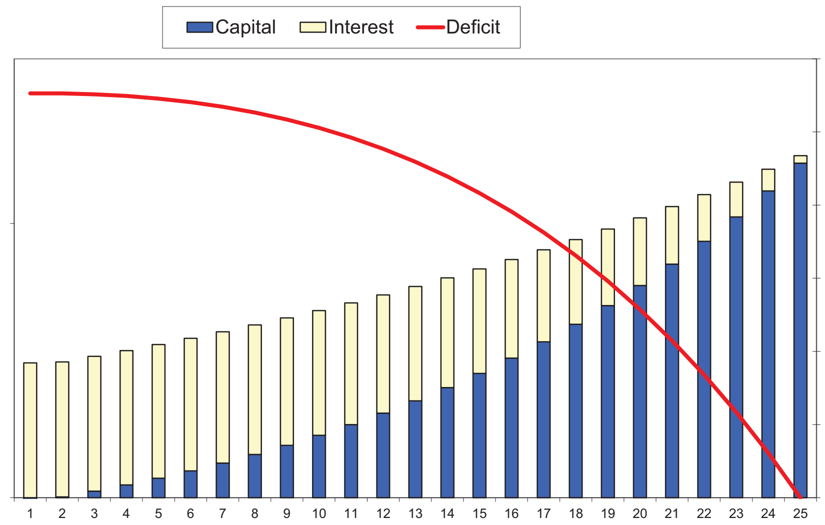
18 years



25 years



A key aspect of determining a deficit recovery strategy is the recovery period. The longer the recovery period the more debt "interest" is payable.

FUNDING STRATEGY AND CONTRIBUTION REQUIREMENTS
ISSUES TO BE ADDRESSED IN FSS

Page 138

- ✓ Time horizon for funding plan
- ✓ Link between funding strategy and investment
- ✓ Fund and Employer Policies
- ✓ Risks to the funding strategy
- ✓ Monitoring and review of the strategy
- ✓ Financial standing of employers and impact on funding assumptions

SCHEME EMPLOYERS

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SCHEME EMPLOYERS
DIFFERENT EMPLOYERS IN THE FUND

SCHEDULED BODIES

Councils,
Universities, Colleges
Fire / Police Authorities, etc.

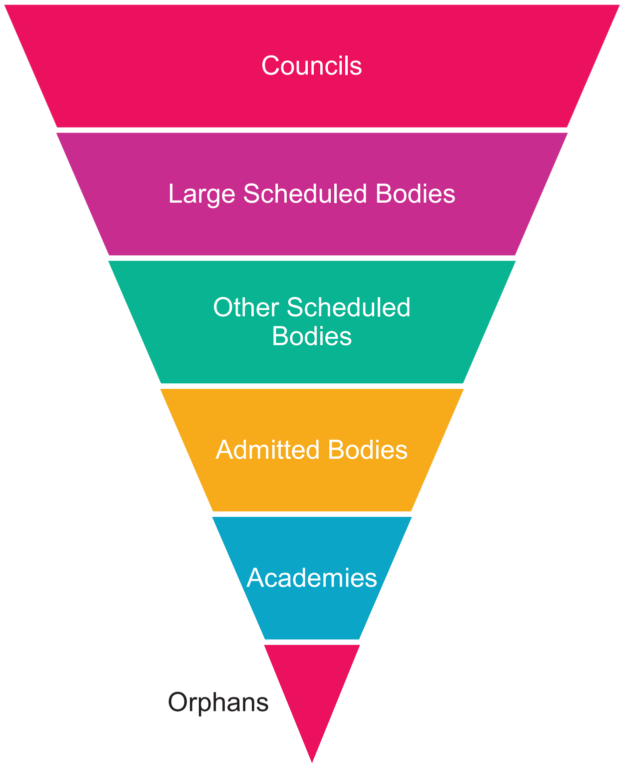
ADMITTED BODIES

Outsourcing contractors
Charitable bodies
Housing associations, etc.

EMPLOYERS HAVE DIFFERENT **CHARACTERISTICS** AND **OBJECTIVES**

MANAGING EMPLOYERS

TYPES OF EMPLOYERS



KEY EMPLOYER FEATURES:

- FUNDING LEVEL
- SIZE & MATURITY
- COVENANT
- EMPLOYER OBJECTIVES

SETTING EMPLOYER CONTRIBUTIONS:

- INVESTMENT STRATEGY
- AFFORDABLE
- PAYMENTS
- RECOVERY PERIODS
- RISK MANAGEMENT /PROTECTION

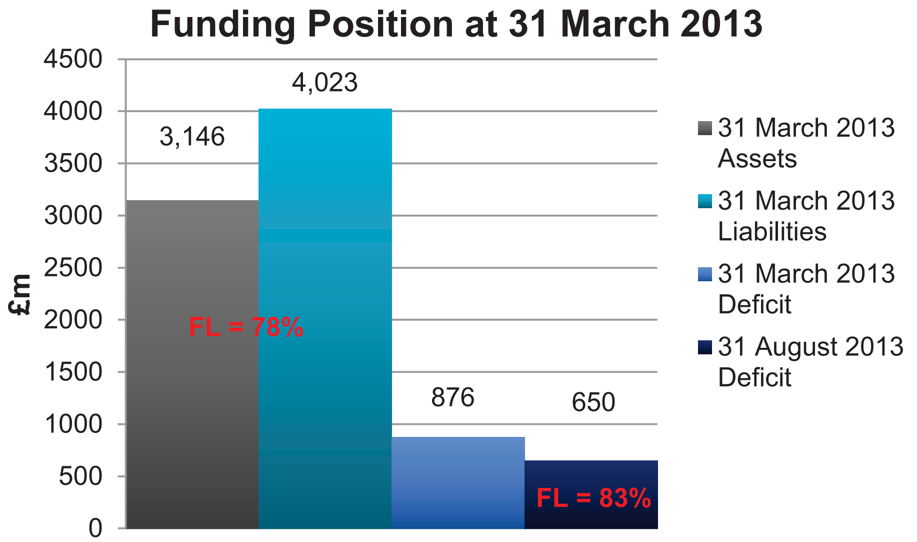
RECAP – 2013 VALUATION AND FUNDING STRATEGY

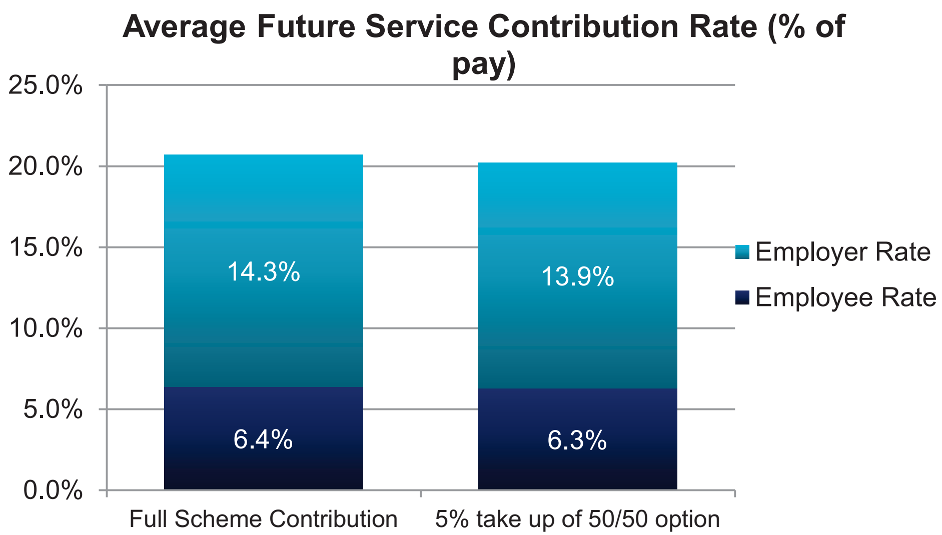
RECAP – KEY FINANCIAL ASSUMPTIONS

	31 March 2013	31 August 2013
CPI Inflation	2.6% p.a.	2.6% p.a.
Discount rate for past benefits (Gilts +1.6% p.a.)	4.8% p.a. (= CPI + 2.2% p.a.)	5.2% p.a. (= CPI + 2.6% p.a.)
Discount rate for future benefits (CPI +3.0% p.a.)	5.6% p.a.	5.6% p.a.
Salary Increases - Long Term - Short Term	4.1% p.a. 1.0% p.a. to 2015	4.1% p.a. 1.0% p.a. to 2015

Final recovery contributions were based on the 31 August 2013 funding position due to the material market shift

2013 RESULTS- RECAP WHOLE FUND





Current average future service contributions (13.9% of pay) = c£81m pa	
Average Recovery period (Whole Years)	Certified Average Deficit Payment (increasing with assumed pay growth)
20	2015/16 - £39m 2016/17 - £41m 2017/18 - £43m
Total average contributions in 2015/16 = c£120m	

Note: Future service contributions are based on a payroll of £580m and we have ignored the deficit prepayments made for ease of comparison with update results

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2013 VALUATION - INDIVIDUAL EMPLOYERS
RANGE OF OUTCOMES

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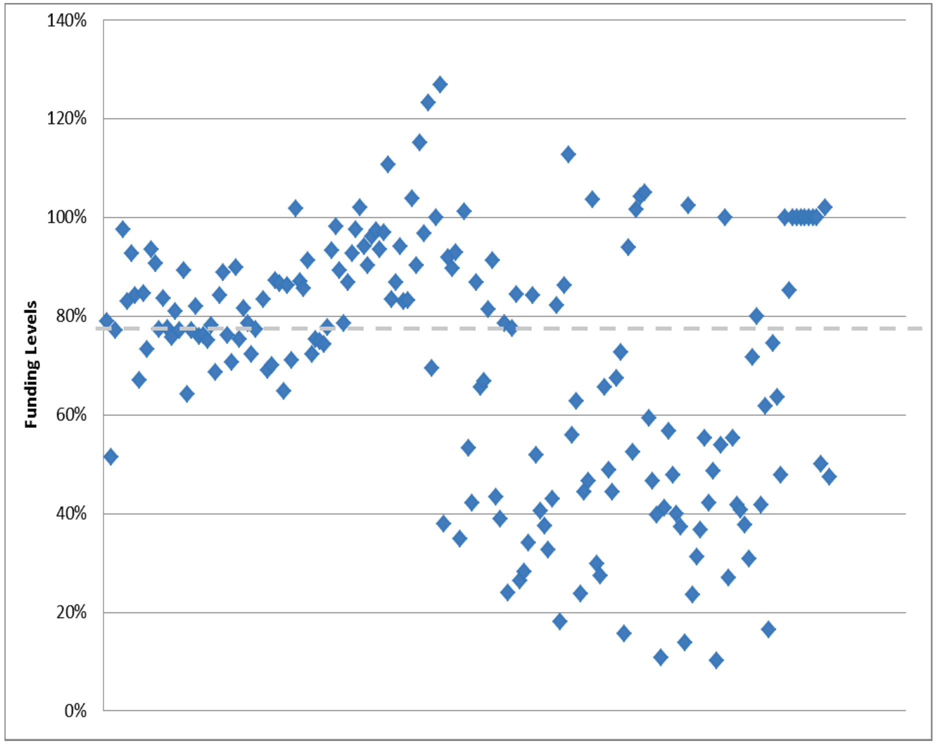
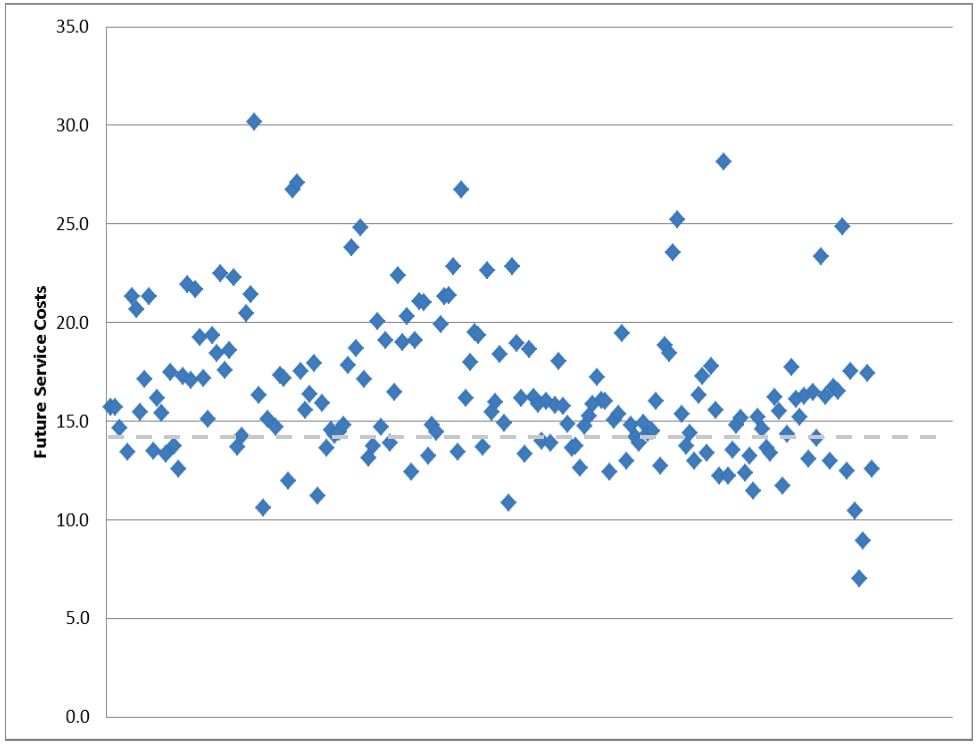
Funding levels



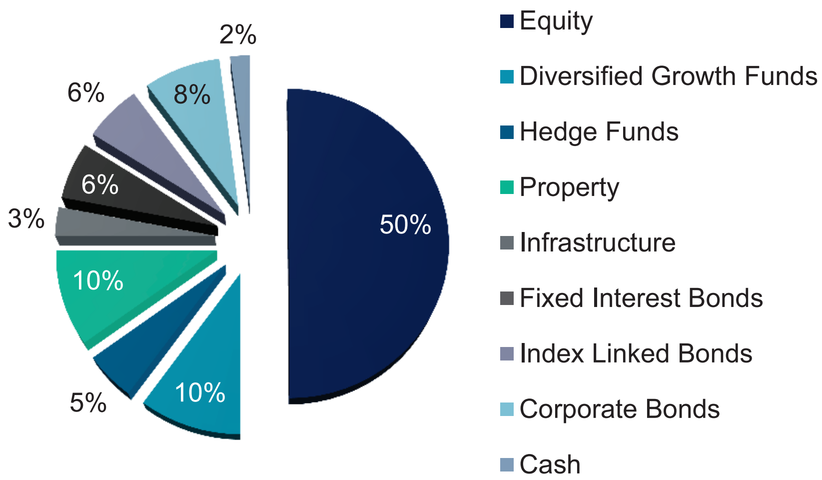
Future service rates



2015 INTERIM REVIEW

DISCOUNT RATE
CURRENT EXPECTED INVESTMENT RETURNS

Your strategic asset allocation



Asset Class	Best Estimate Expected Real Return vs CPI
Equities	CPI + 4.6% p.a.
Diversified Growth Funds	CPI + 3.8% p.a.
Hedge Funds	CPI + 2.4% p.a.
Property	CPI + 3.0% p.a.
Infrastructure	CPI + 4.3% p.a.
Corporate Bonds	CPI + 1.0% p.a.
Government Bonds	CPI + 0.1% p.a.
Overall Median	**CPI + 3.4% p.a.**

Range of outcomes

Chance of achieving return	Expected Real Return
50%	CPI + 3.4% p.a.
55%	CPI + 3.0% p.a.
60%	CPI + 2.5% p.a.
65%	CPI + 1.9% p.a.
70%	CPI + 1.3% p.a.
75%	CPI + 0.7% p.a.

More prudent

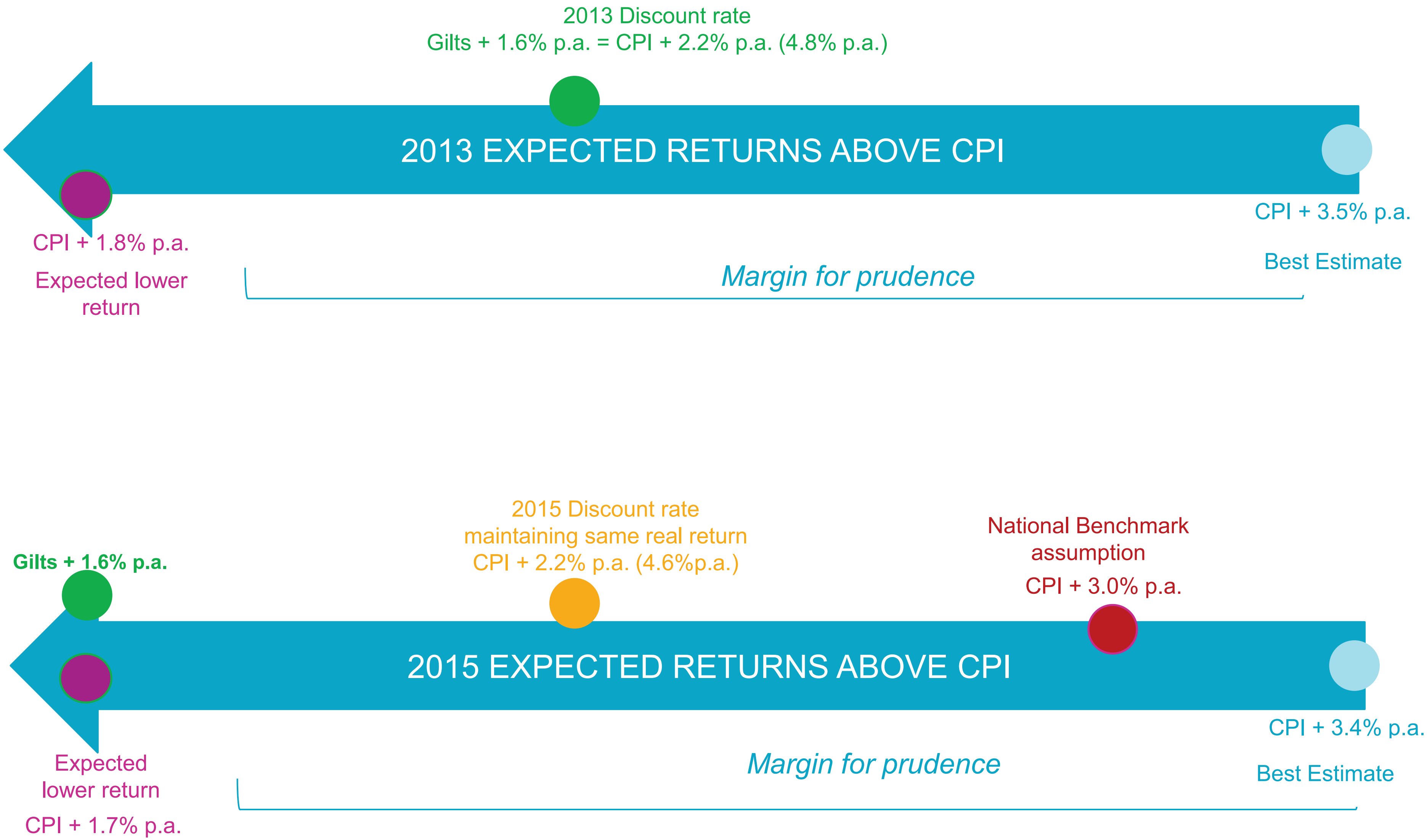
Comments

To develop the discount rate we ultimately look at the expected returns on the assets relative to CPI.

This can be done on the ***current*** benchmark investment strategy or on an ***aspirational*** lower risk strategy.

At 31 March 2013 the equivalent discount rate relative to CPI was CPI + 2.2% p.a. (CPI plus 3.0% p.a. for future service rate). Deficit contributions were predominately derived based on August 2013 yields which is equivalent to CPI + 2.6% pa

2015 ACTUARIAL ASSUMPTIONS
LEVEL OF PRUDENCE



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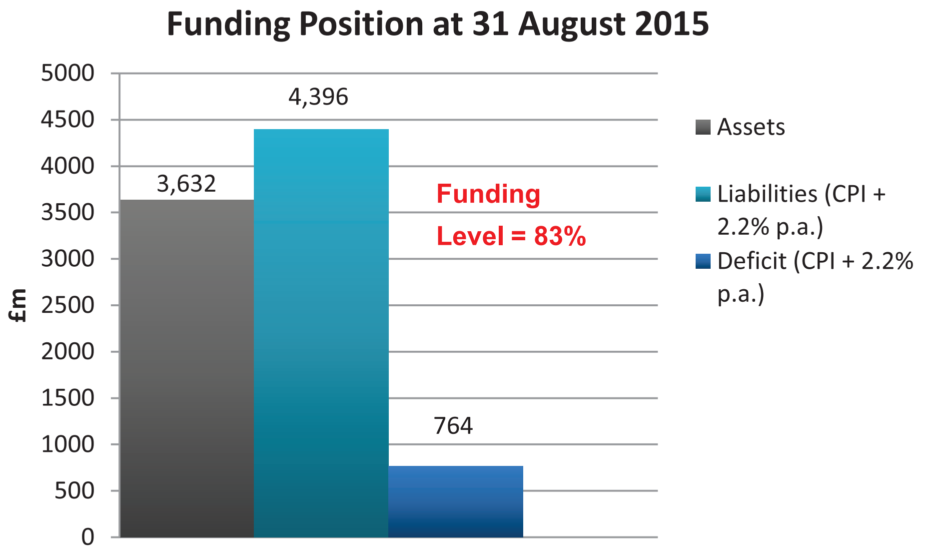
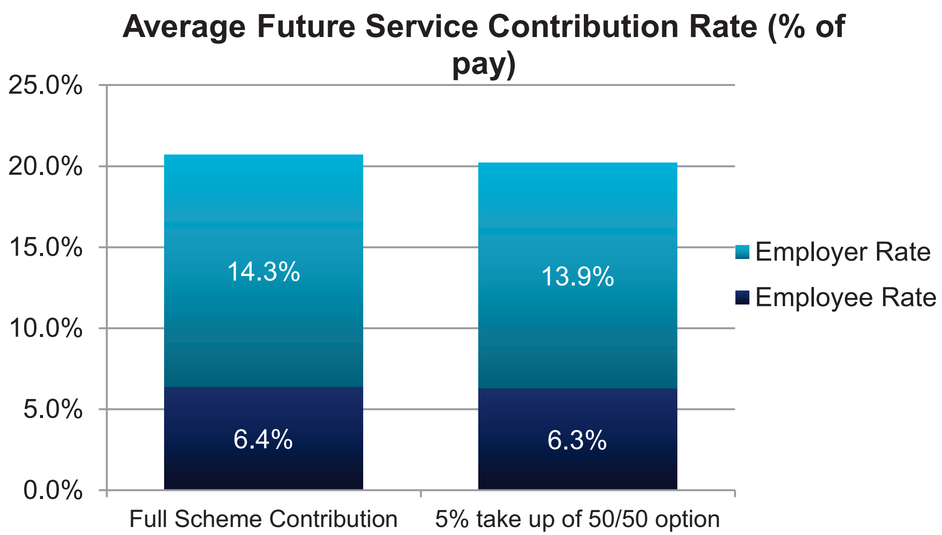
2015 UPDATE
FINANCIAL ASSUMPTIONS

Market yields	31 August 2015
Fixed interest gilt yield	2.5% p.a.
Index-linked gilt yield	-0.9% p.a.
Assumed CPI price inflation (RPI derived by differencing yields on fixed-interest and index-linked gilts less 1% p.a. RPI/CPI gap)	2.4% p.a.
Assumptions used for Liabilities	
Derivation of Discount Rate /Expected Return	CPI plus 2.2% p.a. (CPI + 3.0% p.a. for future service rate)
Discount rate/Expected Return:	4.6% p.a.
Inflation: Consumer Prices Index (CPI)	2.4% p.a.
Pay inflation	3.9% p.a.
Pension increases	2.4% p.a.
Short term pay assumption	1% p.a. to 2019
Fund investment return	Approx.14.3% from 1 April 2013 to 31 August 2015

WHOLE FUND – SHORT TERM PAY GROWTH (1% P.A. TO 2019)





Average deficit contributions (2015/16 equivalent deficit contributions of £39m p.a.)	
	Required Payment (increasing with assumed pay growth)
Based on a deficit of £764m (CPI plus 2.2% p.a.) payable over c19 years i.e. from 1 September 2015	2015/16 - £43m 2016/17 - £44m 2017/18 - £46m

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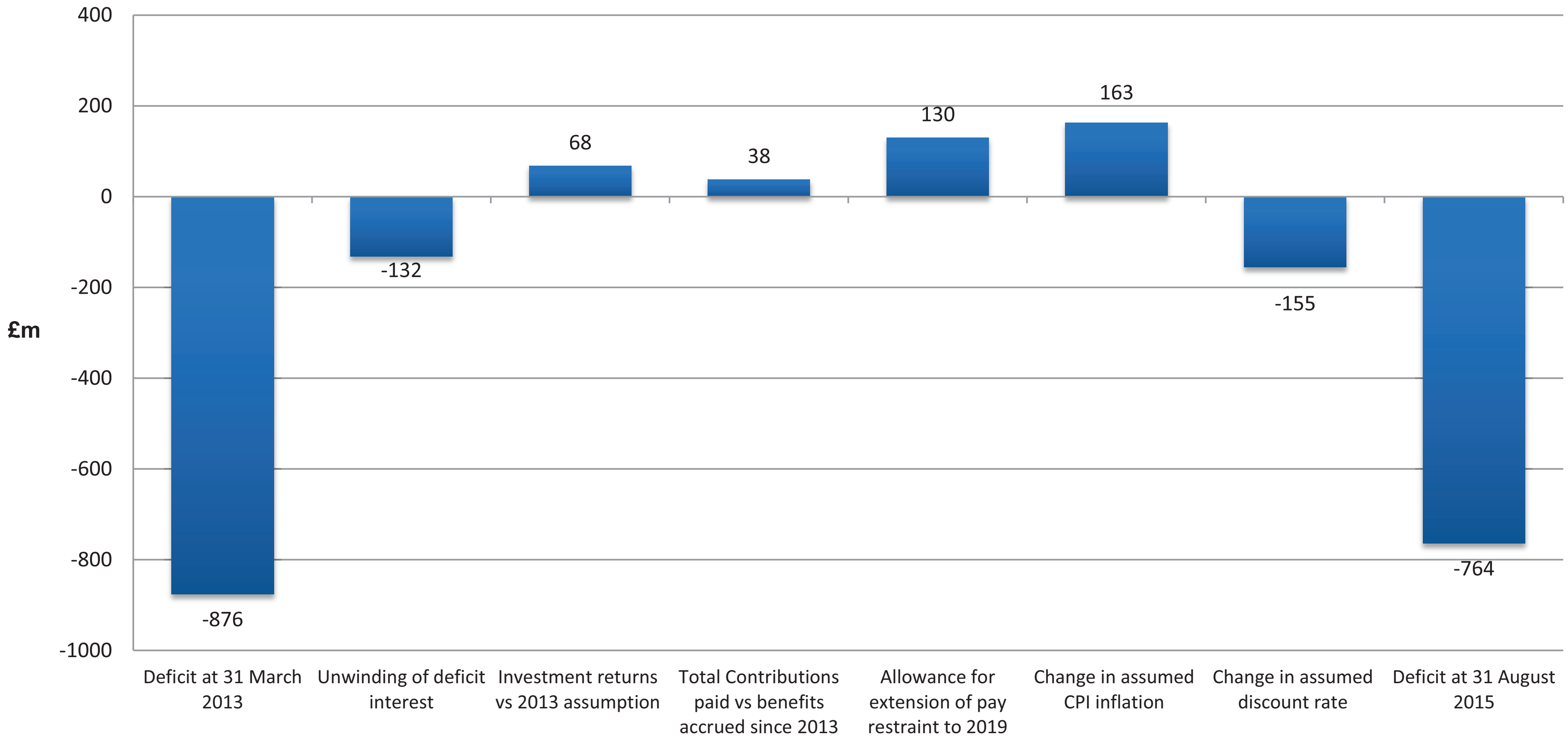
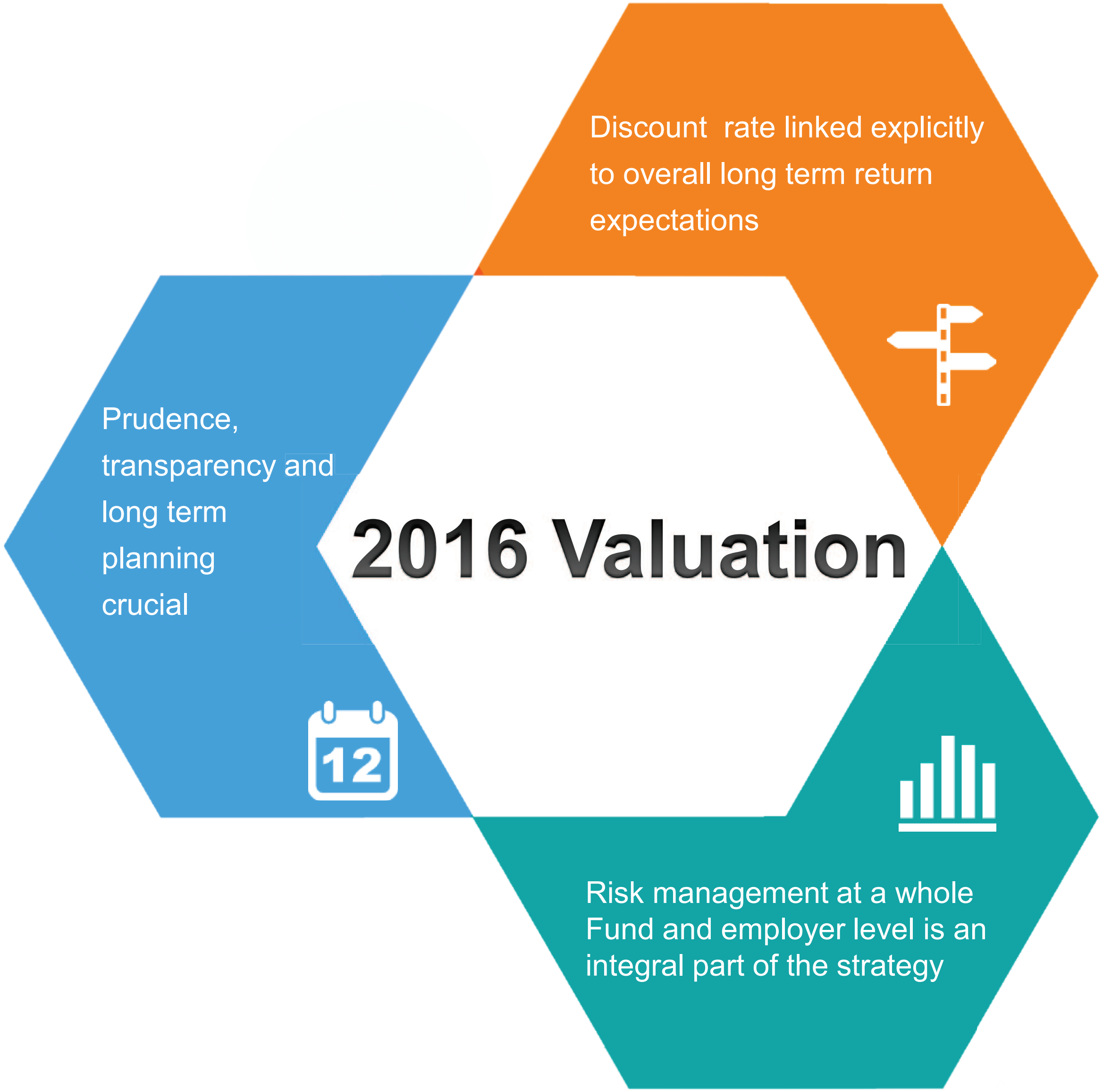
2013 RESULTS
ANALYSIS OF CHANGE IN DEFICIT POSITION



Discount Rate	Lower Real Return vs CPI	Same Real Return vs CPI at 2013	National Benchmarking basis
Real return over CPI i.e. investment return "hurdle rate"	**1.7% p.a. (3.0% p.a. for Future Service)**	2.2% p.a. (3.0% p.a. for Future Service)	3.0% p.a.
Deficit[1]	**£1,181m**	£764m	**£187m**
Funding Level	**76%**	83%	95%
Future Service Rate (% of pay per annum)	**13.9%**	13.9%	n/a
Deficit contributions payable over c19 years (2015/16)	**£63m p.a.**	£43m p.a.	n/a
Average Future Service Contributions (2015/16) based on payroll of £580m	**£81m p.a.**	£81m p.a.	n/a
Total contributions payable	**£144m p.a.**	£124m p.a.	n/a

[1]includes allowance for short term pay of 1% p.a. for 4 years up to 2019 for illustration

CONCLUSIONS



2016 VALUATION – EXAMPLE TIMELINE

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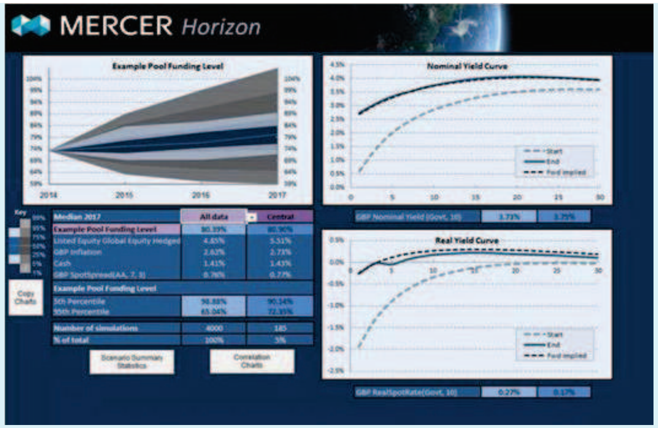
2015Q3	2015Q4	2016Q1/2	2016Q2/3	2016Q3	2016Q4/ 2017Q1
INITIAL DISCUSSIONS	DEVELOP FUNDING STRATEGY	PRELIMINARY CALCULATIONS	RESULTS/ REVIEW FSS	DISCUSSIONS WITH EMPLOYERS	COMPLETE

MONITOR UP TO THE VALUATION AND BEYOND



ACTUARIAL ADVICE

- We have prepared this document for the Administering Authority for the purpose of consideration of the funding strategy and 2016 valuation planning.
- Where appropriate the work is covered by and compliant with the following Technical Actuarial Standards (TAS) issued by the Financial Reporting Council: TAS R – Reporting Actuarial Information; TAS D – Data; TAS M – Modelling; and Pensions TAS.
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- This presentation is correct as at October 2015. It will not be updated unless requested.

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MAKE
TOMORROW,
TODAY

MERCER

Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND COMMITTEE**	
MEETING DATE:	**11 DECEMBER 2015**	**AGENDA ITEM NUMBER**
TITLE:	**INVESTMENT PANEL ACTIVITY**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Minutes from Investment Panel meeting held 18 November 2015

Appendix 2 – Mercer report: Bond Assets Reorganisation

Appendix 3A: Revised Rebalancing Policy,

Appendix 3B: Current Rebalancing Policy

EXEMPT Appendix 4 – Summaries of Investment Panel meetings with Managers

1 THE ISSUE

1.1 The Investment Panel is responsible for addressing investment issues including the investment management arrangements and the performance of the investment managers. The Panel has delegated responsibilities from the Committee and may also make recommendations to Committee. This report informs Committee of decisions made by the Panel and any recommendations.

1.2 The Panel has held one formal meeting since the September 2015 committee meeting, on 18 November 2015. The draft minutes of the Investment Panel meeting provides a record of the Panel's debate before reaching any decisions or recommendations and can be found in Appendix 1.

1.3 The Panel also held a Meet the Managers Workshop on 9 November 2015, a summary of the meetings is at Exempt Appendix 4.

1.4 The recommendations and decisions arising from these meetings are set out in paragraphs 4.2 and 4.3.

2 RECOMMENDATION

That the Committee:

2.1 On managing liabilities

(1) **Agrees the recommendation to increase the benchmark allocation and allocation range to Index Linked Gilts as at 4.2 a) to better match liabilities.**

(2) **Notes the decision by the Panel to prepare a framework to more effectively use the investment assets to match the liabilities, as set out in 4.2 b).**

2.2 Agrees the recommendation to adopt the proposed rebalancing policy as at 4.3 a).

3 FINANCIAL IMPLICATIONS

3.1 In general the financial impact of decisions made by the Panel will have been provided for in the budget or separately approved by the Committee when authorising the Panel to make the decision.

3.2 There are transactional costs involved in appointing and terminating managers. Where these arise from a strategic review allowance will be made in the budget. Unplanned changes in the investment manager structure may give rise to transition costs which will not be allowed for in the budget.

4 RECOMMENDATIONS AND DECISIONS

4.1 The following decisions and recommendations were made by the Panel at the Investment Panel meeting on 18 November 2015:

4.2 **Managing Liabilities**:

The Committee requested that the Panel review the range of investment options available to more effectively manage liability risks, how they may be implemented and the potential cost. Having considered a report and additional analysis from Mercer, the Panel agreed the following:

a) Recommendation for agreement – interim step.

Increase the benchmark allocation to Index Linked Gilts (ILG) above the current permissible range to allow the current allocations to gilts and overseas bonds to be allocated to ILG. The benchmark allocations for Fixed Interest Gilts and Other Bonds will therefore be zero. This will require the allocation range for ILG to change from 3-10% to 9-15%. The allocation ranges for Fixed Interest Gilts and Other Bonds are unchanged.

Rationale – Increasing the allocation to index linked gilts will improve the matching characteristics of the stabilising assets against the liabilities with no reduction in the expected return on assets. Please see Appendix 2 for a full explanation provided by Mercer. This interim step is beneficial regardless of whether the full proposal (referred to below in (b) and still to be developed) is agreed or not.

b) Decision for noting – to develop a full proposal to more effectively match liabilities.

That, in principle, the Fund should consider putting a framework in place to more effectively use the investment assets to match the liabilities, and to prepare the proposed framework for recommendation to the Committee (including costs).

It is planned that the Panel will agree a framework for consideration by Committee in June or September 2016 (so that it can be considered as part of the 2016 valuation).

4.3 **Review of Rebalancing Policy**:

The Fund's policy is to rebalance the investment portfolio back to the target asset allocations after market movements cause allocations to vary by a certain amount. Rebalancing is important as it ensures the Fund is invested in line with the strategic allocation. Rebalancing can also add value over time as it forces the selling of relatively expensive assets and the purchasing of relatively cheap assets.

The Panel reviewed the Fund's rebalancing policy to ensure it remains appropriate. Having considered a report produced by Mercer the Panel made the following recommendations to revise the policy:

a) Recommendation for agreement - That the Fund should adopt the revised rebalancing policy at Appendix 3A (the current policy is also included as Appendix 3B for reference).

Rationale – The revisions to the policy seek to:

- *Improve the efficiency of the rebalancing policy by having narrower ranges within which asset allocations are allowed to fluctuate.*
- *Provide for a more robust decision making framework for making use of the flexibility outside of the narrow ranges (but within the ranges permitted in the Fund's Statement of Investment Principles) based on whether an asset class is deemed unattractive or attractive by the investment consultant.*
- *Confirm clearer delegations to Panel, Officers and Consultant to implement the policy.*

Committee Delegation – Committee decide the rebalancing policy and delegate the implementation of the policy to the Panel who in turn delegate it to Officers in consultation with the Investment Consultant where appropriate.

4.4 The Statement of Investment Principles and Rebalancing Policy will be updated following any changes agreed by Committee.

5 INVESTMENT PANEL DELEGATION

5.1 The activity was undertaken under in line with the delegation set out in the Fund's Terms of Reference approved in May 2015:

The Investment Panel will:

1. *Review strategic and emerging opportunities outside the strategic asset allocation and make recommendations to the Committee.*
2. *Review the Statement of Investment Principles and submit to Committee for approval.*
3. *Report regularly to Committee on the performance of investments and matters of strategic importance*

and have delegated authority to:

4. *Approve and monitor tactical positions within strategic allocation ranges.*
5. *Approve investments in emerging opportunities within strategic allocations.*
6. *Implement investment management arrangements in line with strategic policy, including the setting of mandate parameters and the appointment of managers.*
7. *Approve amendments to investment mandates within existing return and risk parameters.*
8. *Monitor investment managers' investment performance and make decision to terminate mandates on performance grounds.*
9. *Delegate specific decisions to Officers as appropriate.*

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. An Investment Panel has been established to consider in greater detail investment performance and related matters, and to carry out responsibilities delegated by the Committee.

6.2 A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund's future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary as the report is primarily for information only.

8 CONSULTATION

8.1 This report is primarily for information and therefore consultation is not necessary.

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 The issues to consider are contained in the report.

10 ADVICE SOUGHT

10.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Matt Betts, Assistant Investments Manager (Tel: 01225 395420)
Background papers	
Please contact the report author if you need to access this report in an alternative format	

AVON PENSION FUND COMMITTEE - INVESTMENT PANEL

Minutes of the Meeting held

Wednesday, 18th November, 2015, 9.30 am

Members: Councillor Christopher Pearce (Chair), Councillor David Veale, Councillor Cherry Beath, Ann Berresford, Councillor Mary Blatchford and Shirley Marsh
Advisors: Tony Earnshaw (Independent Advisor) Steve Turner (Mercer), and James Giles (Mercer)
Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions), Liz Woodyard (Investments Manager), Matt Betts (Assistant Investments Manager) and Matthew Clapton (Investments Officer)

12 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

13 DECLARATIONS OF INTEREST

There were none.

14 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

There were none.

15 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

16 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

17 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

18 MINUTES: 11 SEPTEMBER 2015

The public and exempt minutes of the meeting of 11 September 2015 were approved as a correct record and signed by the Chair.

19 MANAGING LIABILITIES - ADDITIONAL ANALYSIS

The Investments Manager introduced this item. She reminded members that at the previous meeting they had examined the concept of better matching the Fund's asset base to its liabilities and thereby reducing volatility in the funding position. They had considered the use of index-linked gilts to help with the management of inflation risks throughout the portfolio. At the end of the discussion the Panel had asked for further work to be done, in particular on how the framework would impact on the Fund's portfolios in terms of cash flow. Mercer's had accordingly prepared another presentation, which had been circulated with the agenda. She said that if the decision was taken to adopt the proposal in principle, the implementation would be spread over a period of years and would be taken into account in the next valuation.

Mr Turner and Mr Giles commented on the Mercer document *Risk management framework – further training and scenario analysis*, which had been circulated with the agenda.

Mr Turner said the aim was to address the volatility in and growth of the deficit with a long-term plan to manage risk in an effective way. He reminded Members that since the last valuation the funding level had been as high as 87%, but had now come down to about 75%. Liabilities had increased. At the previous meeting the Panel had decided to implement the first step, which was to switch the Fund's current holdings in fixed interest and overseas and overseas government bonds into index-linked gilts (to hedge 12% of the Fund). Mercer was in addition proposing that leveraging should be used to allow the Fund to match 36% of funded liabilities. The presentation gave details of the hedging instruments that could be employed. These were divided into physical instruments (fixed-interest gilts, corporate bonds, and index-linked gilts) and synthetic/derivative instruments (interest rate swaps, inflation swaps and gilt repos).

The report by Mercer was debated with significant discussion around the concept of leverage, the risks arising from leverage and how they would be managed including credit and counterparty risk and how the cash flows would be effectively hedged.

Responding to comments from the Independent Investment Adviser and from Members about the timing of investments, Mr Turner said timing was important, but there would never be a magic bullet to cope with short-term market changes; what was important was having a long-term plan to increase the level of protection. He did not think that interest rates would rise significantly in the near future. However, the deficit had risen, which would affect the valuation this year, and as the scheme is still open the liabilities will continue to grow.

The Chair asked Mr Turner about the supply of instruments to hedge the liabilities as supply might dry up as an increasing number of pension schemes invested in them, with the implication that the Fund should invest in them as soon as possible. Mr Turner thought that an increase in demand of a magnitude that would exhaust the supply was unrealistic, but a large volume of transactions would keep yields down. The Investments Manager said this needed to put in context, by, for example, comparison with how gilt yields had behaved over the past 10-20 years. Gilt yields are lower than they would be, because of pressure from pension funds to hedge their liabilities. But there were other factors, such as expectations for interest rates and inflation and the Government's stated intention to have a budget surplus rather than a deficit, which made it difficult to predict the trend in gilt yields. Mr Turner said that there was reason not to delay hedging, and the Fund should be considering a three-year programme to increase its investment in hedging instruments.

Representatives from Insight Asset Management gave a presentation on how an investment manager would implement such a strategy and how they would manage the risks and cashflows.
Responding to a question from a Member, the Investments Manager said that hedging of liabilities could be done within a pooling arrangement of LGPS funds, or could be kept independent of the pooling arrangements.

Members had further questions about the complexity of the concept and mechanics of implementation and the difficulty of assessing the risks involved. One said LGPS funds are reluctant to get involved in such investments, because their complexity is challenging. Mr Turner replied that LGPS funds now regularly invested in asset classes that had once seemed too complex.

A Member asked how many LGPS funds were currently using this kind of hedging strategy. Mr Turner said that there were about ten.

The Head of Business, Finance and Pensions referred to the court ruling some years ago that it was unlawful for local authorities to invest in interest rate swaps, which was made after some local authority treasury departments had been using them for about seven years. Local authorities were therefore still cautious about this type of instrument. A Member asked whether it was now lawful for LGPS funds to invest in them. The Investments Manager replied said the investment regulations were going to be reviewed and when updated should allow funds to adopt an investment framework that would allow this. However, funds were currently able to invest via pooled funds. It would take a long time to develop a liability hedging framework, which was why work on it had begun now.

RESOLVED:

1. That, in principle, the Fund should put a framework in placed to more effectively use the investment assets to match the liabilities.

2. To prepare a framework to be considered by the Panel for recommendation to the Committee. The proposal will bring together the work done to date and the proposed framework, including a 3 year plan to increase the level of matching and a longer term plan to reach a target level of matching when affordable.

After the discussion was concluded, the Head of Business, Finance and Pensions said that it was likely that Members still had questions about these issues. He suggested that it would unproductive if at the next meeting there was a rerun of today's discussions, so he invited Members to email any questions or concerns to the Investments Manager. Officers would then prepare a response identifying the benefits that could be achieved from this proposal.

The Chair said that a great deal of information had been presented to Members, and that it was important not to let the details obscure the fundamental issues. He said that a future report should focus on the basic principles and on how and when the proposal might be implemented. The Investments Manager suggested that the framework and the timescale of implementation could not be discussed until the basis for the next valuation was known.

20 REBALANCING POLICY

The Assistant Investments Manager presented the report. He said that there were target allocations for the different asset classes in the Fund, which were permitted to drift within defined ranges. Rebalancing was important to ensure that the Fund's assets remain invested in line with the target investment strategy. It also forced the selling of relatively expensive assets and the purchase of relatively cheap assets, tending to add value over time.

The Fund's current rebalancing policy was given in Appendix 1. For liquid assets the present policy allowed rebalancing between growth and stabilising assets when the balance deviated by +/-2%, and automatic rebalancing took place when the deviation was +/- 5%. Mercer had reviewed the policy and were proposing narrower ranges and a more robust decision-making framework to reflect their views on the market outlook for different asset classes. The table on agenda page 163 showed the proposed rebalancing ranges. Two rebalancing ranges were set for each asset class in addition to the neutral range, according to whether the assets were deemed unattractive or attractive. Mercer's dashboard on page 127 summarised their view of the attractiveness of different asset classes. .

The proposed delegations for the operation of the policy were set out in subparagraphs 4, 5 and 6 of paragraph 6.1 of the report.

The Investments Manager explained that rebalancing was used for cash management.

A Member commented that the 'attractive' range proposed for emerging markets of 9-15% appeared high and out of line with the +/-1% 'neutral' range. She suggested that it might be the right time to increase the benchmark allocation of 10% for emerging markets, where good growth was to be expected in the longer term. Mr Turner said that benchmark for equities overall was 50%, of which emerging markets accounts for about one fifth of this and was a significant allocation.

RESOLVED to recommend to the Committee:

1. the revised rebalancing policy set out in Appendix 3 Section 1.

2. the implementation of the policy to be delegated to officers in consultation with the investment consultants where appropriate, as set out in Appendix 3 Section 2.

21 REVIEW OF INVESTMENT PERFORMANCE

The Assistant Investments Manager introduced this item and summarised the key performance information. He reported that Schroders were still rated amber on the RAG monitoring report, but their relative one-year performance had improved significantly. The mandates with Signet and Gottex had been terminated, so they no longer appeared in the RAG report.

Mr Turner commented on the Mercer investment performance report.

A Member said that she would like to know the ESG ratings of the Fund's investment managers. Mr Turner said this information could be provided.

RESOLVED to note the report.

The meeting ended at 12.23 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services

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AVON PENSION FUND – BOND ASSETS REORGANISATION

Background

At the September 2015 Panel meeting, it was agreed that the Fund's current holdings in Fixed Interest Gilts (c. 3% of the Fund's assets) and Overseas Government Bonds (a further c. 3% of the Fund's assets) would be switched to passively managed Index Linked Gilts in order to better match the nature of the Fund's liabilities (which are predominantly inflation linked).

While the current Statement of Investment Principles permits a modest increase in the Fund's Index Linked Bond holdings, the agreed switch would require a revised benchmark allocation to this asset class. This paper sets out a proposal to Committee for this change, together with the rationale for doing so, and provides a summary of the next steps on implementation.

Current benchmark allocation and ranges

The table below sets out the current benchmark asset allocation, together with permitted ranges:

Asset class	% of Fund	Range
Growth assets	**80%**	**65-85%**
Equities	50%	45-55%
Developed	40%	35-45%
Emerging	10%	5-15%
Diversified Growth Funds	10%	5-15%
Illiquid Growth	20%	15-25%
Hedge Funds	5%	0-7.5%
Property	10%	5-15%
Infrastructure	5%	0-7.5%
Other Growth	0%	0-5%
Stabilising Assets	**20%**	**15-35%**
Government Bonds	3%	0-10%
Index Linked Bonds	6%	3-10%
Corporate Bonds	8%	4-20%
Other (Overseas) Bonds	3%	0-5%
Cash	**0%**	**0-5%**

In order to implement this switch from fixed interest and overseas government bonds to Index Linked Gilts, Panel requests that the benchmark allocation is adjusted to reflect this change. While it could arguably be permitted under the current benchmark by widening the permitted ranges, this is a long-term switch for risk management purposes, and it is therefore more appropriate to reflect this via the central benchmark allocation. Panel proposes retaining a benchmark allocation of 0% to fixed interest gilts and overseas government bonds, with the existing permitted ranges, to allow future flexibility.

In addition, in order to increase the benchmark allocation to Index Linked Bonds to 12%, Panel requests that the permitted range for Index Linked Bonds is shifted from 3-10% to 9-15% (to permit some leeway around the 12% allocation to avoid unnecessary rebalancing, and to allow the full allocation of up to 35% in stabilising assets to be utilised if the maximum 20% is held in corporate bonds).

Finally, Panel proposes renaming the “Government Bond” and “Index Linked Bond” allocations to “Fixed Interest Gilts” and “Index Linked Gilts” to more accurately reflect the stabilising asset allocations.

Recommendation

Panel therefore requests that Committee approve a change to the benchmark allocation, permitted range of holdings and nomenclature for the stabilising asset portfolio, as follows:

Asset class	% of Fund	Range
Stabilising Assets	**20%**	**15-35%**
Fixed Interest Gilts	0%	0-10%
Index Linked Gilts	12%	9-15%
Corporate Bonds	8%	4-20%
Other Bonds	0%	0-5%
Cash	**0%**	**0-5%**

Rationale

The vast majority of the Fund’s projected pension payments have a direct linkage to inflation, while the direct inflation protection provided by the assets is limited at present.

Returns on index linked bonds are linked to inflation and therefore provide a better match to the liabilities than fixed interest bonds, which do not have this linkage In addition, the current fixed interest bonds are shorter duration (i.e. less sensitive to changes in interest rates) than the Fund’s liabilities, while the overseas bonds also introduce currency risk.

Increasing the holdings in Index Linked Gilts will therefore improve the matching characteristics of the stabilising assets against the liabilities with no reduction in the expected return on assets that would result in an increase in contribution requirements.

The proposed switch will also help expedite any future move to improve the level of liability protection through the use of leverage (an area the Panel is currently discussing and on which they will report back to Committee in 2016).

Implementation

Officers and Mercer are currently working with BlackRock to propose a segregated passively managed index-linked gilt portfolio to broadly match the Fund's liability profile. This will be implemented as efficiently as possible, with regard to both direct implementation costs and the timing of the switch from fixed-interest bonds to reflect inflation expectations.

Steve Turner
October 2015

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Section 1 - Proposed Rebalancing Policy

Rebalancing Ranges

1. Allocations to be kept within the appropriate rebalancing ranges set out in Table 1. The neutral range is the range within which the allocation can move before any rebalancing is required, regardless of whether the asset class is deemed attractive or unattractive.
2. If the asset outlook is deemed attractive, then the allocation can be higher than the higher band of the neutral range but it cannot be below the lower band of the neutral range (as per the "Attractive" column in Table 1).

   If the asset outlook is deemed unattractive, then the allocation can be lower than the lower band of the neutral range but it cannot be higher than the higher band of the neutral range (as per the "Unattractive" column in Table 1).
3. Where allocations breach the neutral rebalancing range boundary, action will be taken to rebalance to the benchmark allocation, unless it is decided that the outlook for an asset class is judged to be materially attractive or unattractive to warrant the use of a wider rebalancing range as set out in Table 1.

Table 1: Rebalancing Ranges

Asset class	***Benchmark***	***Permitted Range SIP***	***Neutral rebalancing range***	***"Unattractive" rebalancing range***	***"Attractive" rebalancing range***
Growth assets	***80%***	***65-85%***	***+/- 3%***	***65%-83%***	***77%-85%***
Equities	*50%*	*45-55%*	*+/- 2%*	*45%-52%*	*48%-55%*
Developed	*40%*	*35-45%*	*+/- 2%*	*35%-42%*	*38%-45%*
Emerging	*10%*	*5-15%*	*+/- 1%*	*5%-11%*	*9%-15%*
Diversified Growth Funds	*10%*	*5-15%*	*+/- 2%*	*5%-12%*	*8%-15%*
Illiquid Growth, of which:	*20%*	*15-25%*	-	*N/A*	*N/A*
Hedge Funds	*5%*	*0-7.5%*	-	*N/A*	*N/A*
Property	*10%*	*5-15%*	-	*N/A*	*N/A*
Infrastructure	*5%*	*0-7.5%*	-	*N/A*	*N/A*
Other Growth	*0%*	*0-5%*	*Depends on investment*	*N/A*	*N/A*
Stabilising Assets	***20%***	***15-35%***	***+/- 3%***	***15%-23%***	***17%-35%***
Government Bonds	*3%*	*0-10%*	*+/- 1%*	*0%-4%*	*2%-10%*
Index Linked Bonds	*6%*	*3-10%*	*+/- 1%*	*3%-7%*	*5%-10%*
Corporate Bonds	*8%*	*4-20%*	*+/- 2%*	*4%-10%*	*6%-20%*
Other Bonds	*3%*	*0-5%*	*Depends on investment*	*N/A*	*N/A*
Cash	***0%***	***0-5%***	**-**	***N/A***	***N/A***

Illiquid and Other Allocations

4. Illiquid asset classes will be allowed to vary within the permitted range (as per Table 1).
5. The Panel will review illiquid allocations when they breach the permitted range boundary and may do so as they approach the top or bottom of the permitted range but no more frequently than 6 monthly. The timeframe for any rebalancing of illiquid asset allocations will be made with due consideration for liquidity and transaction costs.
6. Neutral rebalancing ranges for the opportunistic ‘other’ investments categories to be agreed on implementation of such investments.

<u>Section 2 – Policy Implementation</u>

Decision Making Process

1. Rebalancing within the neutral rebalancing range will be implemented by Officers.
2. To allow an allocation to remain outside of the neutral rebalancing range but within the relevant (attractive or unattractive) rebalancing range, the process is as follows:
    a. Investment Consultant view of outlook for the asset class must be either attractive or unattractive.
    b. Officers decide it may be beneficial to make use of the wider ranges as set out in Table 1.
    c. Confirmation advice is sought from Investment Consultant before allowing an allocation to remain outside of the neutral rebalancing range (but within the relevant attractive/unattractive rebalancing range).
3. Any positions outside the neutral rebalancing range will be reviewed at Panel meetings.

Implementation Considerations

4. Rebalancing within equities and bonds will take account of performance (of active managers), cost and efficiency considerations.
5. Net new money should be invested pro rata in line with the strategic policy, taking account of tactical positions, and net new money should be utilised first if a rebalancing is triggered.
6. Any positions outside of the neutral rebalancing range will be reviewed at Panel meetings, and all rebalancing activity will be reported to Committee at the following quarterly meeting.
7. This rebalancing policy is overridden by any triggers decided upon when an active tactical asset allocation is put in place on advice from the Investment Consultant.
8. There may be exceptional circumstances where Officers and Advisors agree that the rebalancing framework should be suspended. Committee will be notified of such circumstances.

For approval by Investment Panel, 18 November 2015

Appendix 3B

Current Rebalancing Policy

(1) For the ratio between and equities / bonds, there is a two-tiered set of boundaries;

   i. A deviation of 2% to 5% is subject to tactical review by Officers, having consulted the Investment Consultant, and

   ii. A deviation of 5% or more results in 'automatic' rebalancing back to at least the 2% threshold. An additional tactical decision is then taken by the Officers supported by the Fund's consultants on whether this is fully rebalanced back to the central benchmark allocation or otherwise.

(2) For hedge funds and property allocations the following will trigger a review by the Investment Panel, no-less than 6 monthly:

   i. Property +/- 5% (i.e. a range of 5% to 15% of Fund assets)

   ii. Fund of Hedge Fund +5% (i.e. a max range of 15% of Fund assets)

(3) Rebalancing within equities and bonds will be based on the strategic benchmark and performance (of active managers) and will take account of any tactical position

(4) Net new money should be invested pro rata in line with the strategic policy, taking account of tactical positions, and net new money should be utilised first if a rebalancing is triggered.

(5) The rebalancing policy will be implemented by Officers, having consulted the Investment Consultant. Any recommendations from the Panel regarding (2) would have to be agreed by the Committee.

(6) Any rebalancing activity will be reported to Committee at the following quarterly meeting.

Approved by Avon Pension Fund 22 June 2012.

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Bath & North East Somerset Council

Access to Information Arrangements

Exclusion of access by the public to Council meetings

Information Compliance Ref: LGA-1696/15

Meeting / Decision: AVON PENSION FUND COMMITTEE
Date: 11 December 2015

Author: Matt Betts
Report Title: Item 11 - Investment Panel Activity EXEMPT Appendix 4 – Summaries of Investment Panel meetings with Investment Managers

The Report contains exempt information, according to the categories set out in the Local Government Act 1972 (amended Schedule 12A). The relevant exemption is set out below.

Stating the exemption: 3. *Information relating to the financial or business affairs of any particular person (including the authority holding that information).*

The public interest test has been applied, and it is concluded that the public interest in maintaining the exemption outweighs the public interest in disclosure at this time. It is therefore recommended that the Report be withheld from publication on the Council website. The paragraphs below set out the relevant public interest issues in this case.

<u>PUBLIC INTEREST TEST</u>

If the Committee wishes to consider a matter with press and public excluded, it must be satisfied on two matters.

Firstly, it must be satisfied that the information likely to be disclosed falls within one of the accepted categories of exempt information under the Local Government Act 1972. Paragraph 3 of the revised Schedule 12A of the 1972 Act exempts information which relates to the financial or business affairs of the organisations which is commercially sensitive to the organisations. The officer responsible for this item believes that this information falls within the exemption under paragraph 3 and this has been confirmed by the Council's Information Compliance Manager.

Secondly, it is necessary to weigh up the arguments for and against disclosure on public interest grounds. The main factor in favour of disclosure is that all possible Council information should be public and that increased openness about Council business allows the public and others affected by any decision the opportunity to participate in debates on important issues in their local area. Another factor in favour of disclosure is that the public and those affected by decisions should be entitled to see the basis on which decisions are reached.

Weighed against this is the fact that the exempt report and appendix contains the opinions of Council officers and Panel members. It would not be in the public interest if advisors and officers could not express in confidence opinions which are held in good faith and on the basis of the best information available.

The exempt appendix also contain details of the investment processes/strategies of the investment managers. The information to be discussed is commercially sensitive and if disclosed could prejudice the commercial interests of the investment managers.

It is also important that the Committee should be able to retain some degree of private thinking space while decisions are being made, in order to discuss openly and frankly the issues under discussion relating to the investment managers in order to make a decision which is in the best interests of the Fund's stakeholders.

The Council considers that the public interest has been served by the fact that a significant amount of information regarding the Investment Performance Report has been made available – by way of the main report. The Council considers that the public interest is in favour of not holding this matter in open session at this time and that any reporting on the meeting is prevented in accordance with Section 100A(5A)

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Document is Restricted

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Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**11 DECEMBER 2015**
TITLE:	**REVIEW OF INVESTMENT PERFORMANCE (for periods ending 30 September 2015)**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer Performance Monitoring Report Appendix 3 – LAPFF Quarterly Engagement Monitoring Report Appendix 4 – Revised Statement of Investment Principles	

1 THE ISSUE

1.1 This paper reports on the investment performance of the Fund and seeks to update the Committee on routine strategic aspects of the Fund's investments and funding level. This report contains performance statistics for periods ending 30 September 2015.

1.2 The main body of the report comprises the following sections:

Section 4. Funding Level Update
Section 5. Investment Performance: A - Fund, B - Investment Managers
Section 6. Investment Strategy
Section 7. Changes to Statement of Investment Principles
Section 8. Portfolio Rebalancing and Cash Management
Section 9. Annual Assurance on Control Environment of 3rd Party Suppliers
Section 10. Corporate Governance and Responsible Investment (RI) Update

2 RECOMMENDATION

The Avon Pension Fund Committee is asked to:

2.1 **Note the information set out in the report**

2.2 **Note LAPFF Quarterly Engagement Report at Appendix 3**

2.3 **Agree minor updates to the Statement of Investment Principles (SIP) as explained in Section 7, and approve the revised SIP in Appendix 4.**

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund from 1 April 2013 will affect the next triennial valuation in 2016. Section 4 of this report discusses the trends in the Fund's liabilities and the funding level.

4 FUNDING LEVEL

4.1 Using information provided by the Actuary, Mercer has analysed the funding position as part of the report at Appendix 2 (section 2). This analysis shows the impact of both the assets and liabilities on the (estimated) funding level. ***It should be noted that this is just a snapshot of the funding level at a particular point in time.***

4.2 Key points from the analysis are:

(1) The funding level has fallen c.4% over the quarter from 77% to c. 73% and the deficit has risen from c. £1.1bn to c. £1.35bn.

(2) The deterioration over the quarter was largely due to negative returns from major asset classes over the quarter and a fall in the discount rate from 4.3% to 4.0% increasing the value of liabilities. There was a slight fall in long term inflation but not enough to offset the fall in the discount rate.

Note: this funding level is based on the 2013 valuation assumptions including the discount rate. In the earlier agenda paper "Interim Valuation 2015", the actuary modified the discount rate which resulted in a higher funding position than the one reported here.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets decreased by £129m (a return of -3.6%) in the quarter, giving a value for the investment Fund of £3,601m at 30 September 2015. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers. Manager performance is monitored in detail by the Panel. The Fund's investment return and performance relative to benchmark is summarised below.

Table 1: Fund Investment Returns
Periods to 30 September 2015

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	-3.6%	2.2%	8.3%
Avon Pension Fund (excl. currency hedging)	-2.8%	2.5%	8.3%
Strategic benchmark (no currency hedging) *(Fund incl hedging, relative to benchmark)*	-2.5% *(-1.1%)*	2.8% ***(-0.6%)***	7.7% *(+0.6%)*
Local Authority Average Fund *(Fund incl hedging, relative to benchmark)*	-3.5% *(-0.1%)*	2.5% ***(-0.3)***	8.3% *(0.0%)*

5.2 **Fund Investment Return:** All Equity markets produced negative returns over the quarter in Sterling terms. Emerging Markets was the worst performing region (-

15.6%) whilst the UK All Share Index fell by -5.7%. Bond yields fell across all maturities leading to positive returns from Gilts 5.1% and Corporate Bonds 1%.

5.3 Over 3 years asset class performance was mixed compared to their strategic return assumption. Developed Market Equities, UK Gilts, Index Linked Gilts and Property were all ahead of the assumed return whilst Corporate Bonds were marginally behind. Overseas Fixed Interest and Hedge Funds were behind whilst Emerging Market Equities were significantly behind the assumption.

5.4 **Fund Performance versus Benchmark: -0.3% over 12 months, attributed to**

(1) **Asset Allocation:** The contribution to outperformance from asset allocation was **0.3%** over the 12 months. This was due to the underweights to hedge funds and emerging market equities, and an overweight to overseas equities. The currency hedging programme detracted -**0.3%** over 1 year.

(2) **Manager Performance:** In aggregate, manager performance detracted -**0.3%** of the outperformance over the 12 month period, relative to the strategic benchmark, driven by under performance in diversified growth, hedge funds and property versus their individual benchmarks.

5.5 **Versus Local Authority Average Fund:** Over one year, the Fund underperformed the average fund and was in line over 3 years.

5.6 **Currency Hedging:** The hedging programme is in place to manage the volatility arising from overseas currency exposure, in particular to protect the Fund as sterling strengthens and returns from foreign denominated assets reduce in sterling terms. The hedging programme detracted -0.8% to the total Fund return over the quarter and -0.3% over the year.

B – Investment Manager Performance

5.7 Nine mandates met or exceeded their three year performance benchmark, which offset underperformance by Partners, Signet, Gottex and Schroder Global Equity. SSgA, RLAM, and Jupiter all continue to perform particularly well against their three year performance targets.

5.8 Under the Red Amber Green (RAG) framework for monitoring manager performance, the Panel consider updates on all managers not currently achieving Green status including progress on action points. Any change in the RAG status of any manager is reported to Committee with an explanation of the change. **This quarter no changes have been made to any managers rating.** Currently 1 manager is amber rated, Schroder (global equity) and Panel are monitoring performance which has shown signs of improvement over recent quarters.

6 INVESTMENT STRATEGY

6.1 Infrastructure: The Fund’s investments in infrastructure are awaiting drawdown by the selected manager IFM who anticipate the funds being drawn down over the next 12 to 18 months.

6.2 The Investment Panel is undertaking a review of the Fund’s management of liability risk which will form a significant part of the workplan over the coming months.

7 CHANGES TO STATEMENT OF INVESTMENT PRINCIPLES

7.1 The Fund’s Statement of Investment Principles (SIP) sets out the Fund’s investment strategy and policies and states how the Fund complies with the Myners Principles for Effective Decision Making. The requirement to produce a

SIP is set out in the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2009. These regulations provide that “the written statement must be revised by the administering authority in accordance with any material change in their policy … and published”.

7.2 The SIP has been updated to reflect the changes to the currency hedging mandate from an active dynamic approach to a passive approach as agreed by the Investment Panel and notified to Committee in September. The list of Investment Manager mandates has also been updated to reflect the fund of hedge fund mandates that have been (or are in the process of being) redeemed and the new fund of hedge funds mandate managed by JP Morgan has now been seeded.

7.3 The Committee is asked to approve the revised SIP in Appendix 4.

8 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

8.1 The rebalancing policy requires automatic rebalancing between the allocations to Liquid Growth (equities and diversified growth funds) and Stabilising (Bonds) assets when the liquid growth portion deviates from 75% by +/- 5%. Tactical rebalancing is allowed between deviations of +/- 2 to +/- 5%, on advice from the Investment Consultant. The implementation of this policy is delegated to Officers.

8.2 The Equity (inc. DGFs):Bond allocation is estimated to be 76.5:23.5 at 11 November 2015 which is within the acceptable range, requiring no action.

Cash Management

8.3 Cash is held by the managers at their discretion within their investment guidelines, and internally to meet working requirements. The officers closely monitor the management of the Fund’s cash held by the managers and custodian with a particular emphasis on the security of the cash.

8.4 Management of the cash held internally by the Fund to meet working requirements is delegated to the Council's Treasury Management Team. The monies are invested separately from the Council's monies.

8.5 The Fund continues to deposit internally managed cash on call with NatWest, Bank of Scotland and Svenska Handelsbanken. The Fund also deposits cash with the Goldman Sachs Asset Management Global Treasury Fund (AAA rated). In addition The Fund has access to the Government’s Debt Management Office, however the interest paid currently may not cover the transfer and administration costs incurred.

8.6 During the period there were no breaches of the Fund's Treasury Management Policy (approved June 2015).

9 ANNUAL ASSURANCE ON CONTROL ENVIRONMENT OF 3RD PARTY SUPPLIERS

9.1 As part of the risk management process the Fund annually reviews the internal control reports (ICR) of the custodian and investment managers (and their administrators where relevant), and reports the findings to Committee. These reports are often designated SSAE16 or ISAE3402 reports (previously AAF 01/06 and SAS70 reports), that states which set of standards are being reported against.

9.2 ICR reports describe the internal control environment of an organisation. The management of the organisation are responsible for identifying the control procedures which they consider appropriate to enable certain control objectives to be met. External auditors verify that the controls identified are in place and comment on whether the controls will achieve the stated objectives or not.

9.3 For the reports reviewed in 2014/15, in each case the external auditor's report stated that the controls were in place and achieved the control objective and there are no issues to bring to the attention of the Committee. As part of the process, officers discuss the significance of the internal control reports with investment managers and custodian on an on-going basis and follow-up any issues flagged in the reports.

9.4 The ICRs of the pooled funds (and their administrators/custodian) and the Fund's custodian are also audited by the Fund's external auditor as part of the annual audit.

10 CORPORATE GOVERNANCE UPDATE

10.1 During the quarter, the Fund's external managers undertook the following voting activity on behalf of the Fund:

Companies Meetings Voted:	153
Resolutions voted:	2,205
Votes For:	2,148
Votes Against:	20
Abstained:	9
Withheld* vote:	0

** A withheld vote is essentially the same as a vote to abstain, it reflects a view to vote neither for or against a resolution. Although the use of 'abstain' or 'withheld' reflects the different terms used in different jurisdictions, a 'withheld' vote can often be interpreted as a more explicit vote against management. Both votes may be counted as votes against management, where a minimum threshold of support is required.*

10.2 The Fund is a member of LAPFF, a collaborative body that exists to serve the investment interests of local authority pension funds. In particular, LAPFF seeks to maximise the influence the funds have as shareholders through co-ordinating shareholder activism amongst the pension funds. LAPFF's activity in the quarter is summarised in their quarterly engagement report at Appendix 3.

11 RISK MANAGEMENT

11.1 A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund's future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund and through the selection process followed before managers are appointed. This report monitors (i) the strategic policy and funding level in terms of whether the strategy is on course to fund the pension liabilities as required by the funding plan and (ii) the performance of the investment managers. An Investment Panel has been established to consider in greater detail investment performance and related matters and report back to the committee on a regular basis.

12 EQUALITIES

12.1 An Equality Impact Assessment has not been completed as this report is for information only.

13 CONSULTATION

13.1 This report is for information and therefore consultation is not necessary.

14 ISSUES TO CONSIDER IN REACHING THE DECISION

14.1 The issues to consider are contained in the report.

15 ADVICE SOUGHT

15.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Matt Betts, Assistant Investments Manager (Tel: 01225 395420)
Background papers	LAPPF Member Bulletins, Data supplied by The WM Company
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1

AVON PENSION FUND VALUATION - 30 SEPTEMBER 2015

	Passive Multi-Asset	Active Equities					Enhanced Indexation		Active Bonds	Funds of Hedge Funds		DGFs		Property		In House Cash	TOTAL	Avon Asset Mix %
All figures in £m	BlackRock	TT Int'l	Jupiter (SRI)	Genesis	Unigestion	Schroder Global	Invesco	SSgA	Royal London	JP Morgan	Terminating Mandates	Pyrford	Standard Life	Schroder - UK	Partners - Overseas	Currency Hedging		
EQUITIES																		
UK	198.1	186.1	158.2			36.3											578.7	16.07%
North America	201.3					110.9											312.1	8.7%
Europe	144.1					40.9		40.1									225.0	6.2%
Japan	35.1					18.3		39.5									92.9	2.6%
Pacific Rim	35.7					6.9		30.2									72.9	2.0%
Emerging Markets				132.4	161.6	16.8										0.0	310.8	8.6%
Global ex-UK							260.0										260.0	7.2%
Global inc-UK																17.9	17.9	0.5%
Total Overseas	***416.2***	***0.0***	***0.0***	***132.4***	***161.6***	***193.8***	***260.0***	***109.8***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***17.9***	***1291.6***	**35.9%**
Total Equities	**614.3**	**186.1**	**158.2**	**132.4**	**161.6**	**230.1**	**260.0**	**109.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**17.9**	**1870.3**	**51.9%**
DGFs												**120.9**	**237.0**				**357.9**	**9.9%**
BONDS																		
Index Linked Gilts	236.2																236.2	6.6%
Conventional Gilts	109.1																109.1	3.0%
Corporate Bonds	23.7								281.0								304.8	8.5%
Overseas Bonds	111.3																111.3	3.1%
Total Bonds	**480.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**281.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**761.3**	**21.1%**
Hedge Funds										59.4	97.9						**157.3**	**4.4%**
Property														177.4	150.5		**327.8**	**9.1%**
Cash	5.2	7.7	10.6			2.3								12.1		88.2	**126.1**	**3.5%**
TOTAL	**1099.8**	**193.7**	**168.8**	**132.4**	**161.6**	**232.4**	**260.0**	**109.8**	**281.0**	**59.4**	**97.9**	**120.9**	**237.0**	**189.4**	**150.5**	**106.1**	**3600.7**	**100.0%**

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AVON PENSION FUND

COMMITTEE INVESTMENT PERFORMANCE REPORT
QUARTER TO 30 SEPTEMBER 2015

NOVEMBER 2015

IMPORTANT NOTICES

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Please also note:

- The value of investments can go down as well as up and you may not get back the amount you have invested. In addition investments denominated in a foreign currency will fluctuate with the value of the currency.
- The valuation of investments in property based portfolios, including forestry, is generally a matter of a valuer's opinion, rather than fact.
- When there is no (or limited) recognised or secondary market, for example, but not limited to property, hedge funds, private equity, infrastructure, forestry, swap and other derivative based funds or portfolios it may be difficult for you to obtain reliable information about the value of the investments or deal in the investments.
- Where the investment is via a fund of funds the investment manager typically has to rely on the underlying managers for valuations of the interests in their funds.
- Care should be taken when comparing private equity / infrastructure performance (which is generally a money-weighted performance) with quoted investment performance (which is generally a time-weighted performance). Direct comparisons are not always possible.

CONTENTS

SECTION 1
EXECUTIVE SUMMARY

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EXECUTIVE SUMMARY

	3 months (%)	1 year (%)	3 years (% p.a.)
Total Fund (inc currency hedge)	-3.6	2.2	8.3
Total Fund (ex currency hedge)	-2.8	2.5	8.3
Strategic Benchmark (no currency hedge)	-2.5	2.8	7.7
Relative (inc currency hedge)	**-1.1**	**-0.6**	**+0.6**

Excess Return Chart

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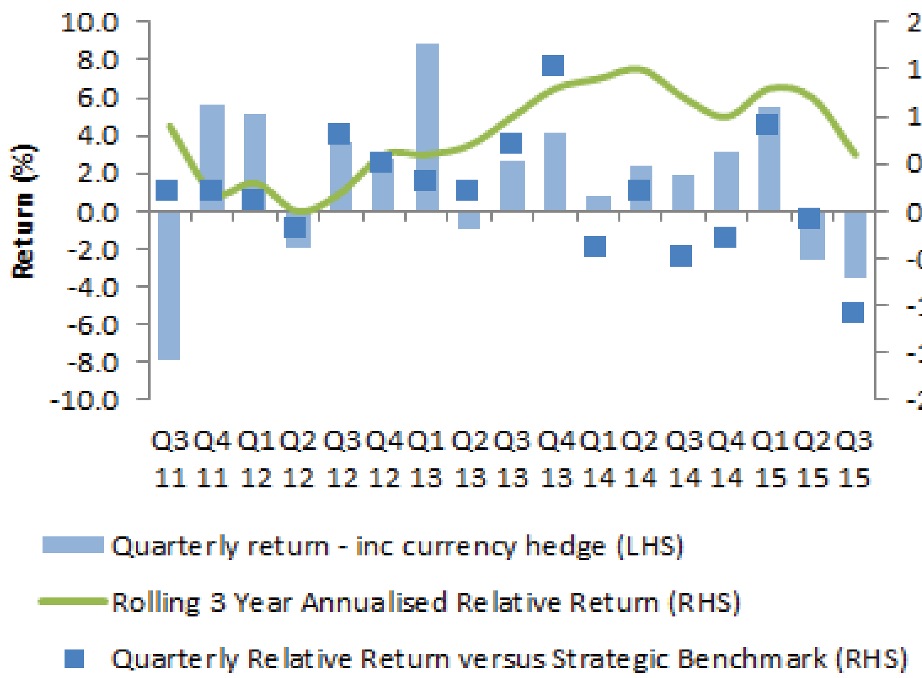
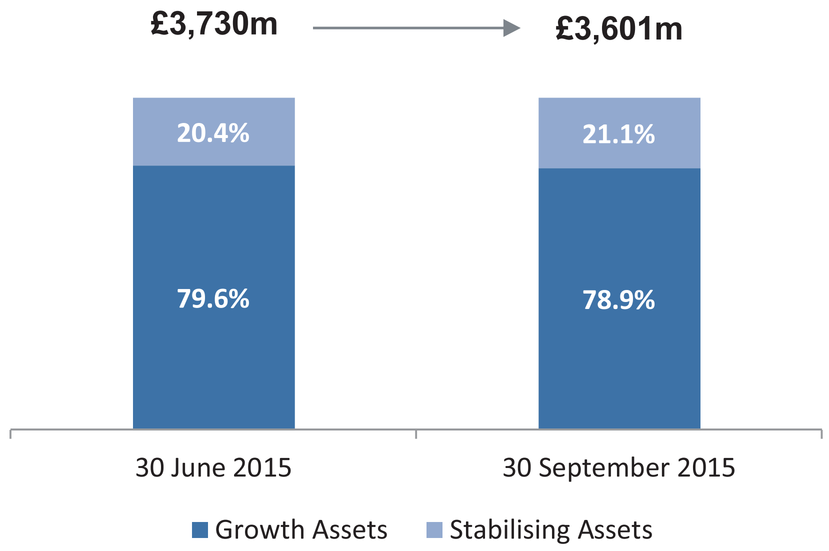


Asset Allocation



Commentary

Over the quarter total Fund assets (including currency hedging) decreased from £3,730m (30 June 2015) to £3,601m.

This decrease was primarily due to the negative performance across most asset classes in the growth portfolio.

At a strategic level, the Fund was within the tolerance ranges in the Statement of Investment Principles for all asset classes. At the start of the quarter, developed equities were overweight but at 30 September 2015 they were within the agreed tolerance ranges as a result of market movements and a switch to the new fund of hedge funds mandate.

The underperformance of the Fund over the quarter was largely due to the overweight position in overseas equities (which produced negative returns over the quarter) and the underweight position in hedge funds, the underperformance of the DGFs relative to their cash benchmark and the depreciation of sterling (which led to negative returns when the currency hedge with Record is included).

EXECUTIVE SUMMARY

This report has been prepared for the Avon Pension Fund ("the Fund"), to assess the performance and risks of the Fund's investments.

Funding level

- The estimated funding level decreased by c. 4% over the third quarter of 2015, due to negative returns from major asset classes over the quarter and a fall in the valuation discount rate (increasing liabilities).

Fund performance

- The value of the Fund's assets decreased by £129m over the quarter, to £3,601m at 30 September 2015. The Fund's assets returned -3.6% over the quarter (-2.8% excluding the Record currency hedging mandate, given the depreciation of sterling over the quarter), as a result of significant negative returns from global equities. This underperformed the benchmark (excluding the currency hedge) return of -2.5%.

Strategy

- Global (developed) equity returns over the last three years at 11.3% p.a. have been significantly ahead of the assumed strategic return of 8.25% p.a. from the strategic review in March 2013. We remain neutral in our medium term outlook for developed market equities (over the next one to three years), and expect returns to be more modest over the next three years.

- The three year return from emerging market equities has fallen back into negative territory at -2.2% p.a. from 5.0% p.a. last quarter. The three year return remains well below the assumed strategic return (of 8.75% p.a.) as returns were affected by negative sentiment from fears of slowing growth in China and uncertainty created by the threat of US interest rates being hiked. As for developed markets, we are neutral in our medium term outlook for emerging market equities over the next one to three years.

Strategy (continued)

- UK government bond returns over the three years to 30 September 2015 remain above the long term strategic assumed returns (with fixed interest gilts returning 6.7% p.a. against an assumed return of 4.5% p.a., and index-linked gilts returning 9.4% p.a. versus an assumed return of 4.25% p.a.) as investor demand for gilts remains high. Whilst from an absolute return perspective government bonds remain unattractive due to the low yields available, we continue to believe that their value in the context of the overall portfolio is important from a liability risk management perspective.
- UK corporate bonds returned 5.1% p.a. over the three year period, falling behind their assumed return of 5.5% p.a., while property returns of 13.7% continue to be above the assumed strategic return of 7% p.a., driven by the economic recovery in the US and the UK.
- Hedge fund returns remain below long term averages and the strategic return of 6% p.a., as they are affected by low cash rates.
- With most listed assets looking close to fully valued if not fully valued, we would expect ‘alpha’ driven investments such as hedge funds and dynamic multi-asset strategies to play an increasingly important role in return generation over the coming three years, particularly if ‘beta’ (i.e. market-driven) returns are lower looking forward. The same also applies to assets that are able to provide a relatively secure source of income (e.g. Infrastructure, Property and Credit), as the overall return is less dependent on capital appreciation.

Managers

- Absolute returns over the quarter were mixed but generally negative as equities produced negative returns over the quarter. Bond markets remained resilient over the quarter, with RLAM returning 0.8%. The lowest absolute return was from Genesis, at -13.1%, however this was a positive relative return of 1.7% as emerging markets fell significantly over the quarter on the back of Chinese concerns and the strong US dollar.
- Returns over the year were more positive. The Fund's global equity mandates in particular fared well, however emerging market returns were still very negative, with Genesis and Unigestion returning -14.1% and -12.9% respectively against a benchmark of -13.4%.
- Over three years, all funds we have performance data for produced positive absolute returns (with the exception of Genesis), with Partners and Gottex failing to beat their benchmarks (although see comments on the measurement of Partners Group's performance later). In addition, Schroder failed to achieve its three-year performance objectives despite beating their benchmark. The remainder of the active managers achieved their objectives.

EXECUTIVE SUMMARY

Key points for consideration

- The hedge fund of funds transition into JP Morgan is ongoing, with £60m invested by 30 September 2015 (with a further £60m invested on 1 October 2015). Stenham has been completely sold down, with £58.4m remaining in Gottex and £38.9m remaining in Signet.
- Global and most regional equity markets produced negative performance over the quarter, hitting the Fund's asset level. This negative experience was compounded by positive performance from bond markets, meaning the present value of the liabilities is expected to have increased.
- After the end of the third quarter, global equity markets rebounded significantly. The FTSE All World fell 5.8% in Q3 and the yield on the FTSE Over 5 Year Index-Linked Gilt index fell from -0.75% p.a. to -0.83% p.a. However, over October the FTSE All World has returned +5.8% in sterling terms, whilst the yield on the FTSE Over 5 Year Index-Linked Gilt index rose from -0.83% p.a. to -0.79% p.a.
- Emerging Markets saw significantly negative performance over the quarter, as fears over China's growth slowing (and whether it had ever been as high as has been stated in the past) took their toll. This, combined with uncertainty created by the US Federal Reserve's potential interest rate hike, caused a significant sell off.
- Property continues its strong performance, despite other growth assets falling over the quarter.
- The Fund is in the process of reviewing the Stabilising Asset portfolio.

SECTION 2
MARKET BACKGROUND

MARKET BACKGROUND
INDEX PERFORMANCE

Equity Market Review

Growth assets continued their downward trend in Q3 as market volatility spiked. In August 2015, intraday equity market volatility rose to levels not seen since the global financial crisis. The sharp sell-off in risk assets was largely attributed to a surprise devaluation of the Chinese Yuan in August 2015. Global equities posted negative returns of 8.1% and 5.8% respectively in local currency and sterling terms over the quarter, with the relative depreciation of sterling partially offsetting the losses of un-hedged investors. Small capitalisation stocks, as measured by the FTSE World Small Cap Index, underperformed the broader market over the quarter, returning -10.8% and -7.4% in local currency and sterling terms, respectively.

Emerging Markets were the worst performing sector, returning -13.2% and -15.6% in local currency and sterling terms, with Latin American and Asian economies leading much of this negative performance. Brazil, in particular, looks set for a deep recession following deteriorating macroeconomic conditions and a downgrade in its credit rating status to junk over the quarter. Within developed market equities, Japanese equities underperformed the broader market following aggressive net selling by foreign investors, returning -13.3% in local currency terms (-8.0% in sterling terms). This underperformance followed the release of mixed economic data which showed Japan falling into deflation in August 2015 (for the first time since April 2013) in spite of improving consumer spending and corporate earnings.

In the United Kingdom, the FTSE All-Share Index fell by 5.7% over the quarter. The FTSE 100 returned -6.1% and continued to underperform the smaller segments of the market represented by the FTSE 250 and FTSE Small Cap indices, largely due to the ongoing weakness of resource-led stocks which constitute a significantly larger proportion of the FTSE 100.

Bond Market Review

Bond yields fell across all maturities over the quarter, resulting in positive returns for investors.

Nominal gilt yields decreased across all maturities during the third quarter, resulting in a return of 5.1% for Over 15 Year Gilts Index.

The real yield curve also moved down, although by less than nominal yields, resulting in a degree of normalization of previously depressed breakeven inflation rates. Index-linked gilts posted a quarterly gain of 2.3%, as measured by the Over 5 Year Index-Linked Gilts index.

Total returns from global credit were +3.0% in the third quarter in sterling terms, with a moderate loss of 0.8% in local currency terms. Credit spreads widened slightly in the UK, but yields still fell overall, resulting in a 1.0% total return on All Stocks UK corporate bonds.

Currency Market Review

Sterling depreciated by 3.7%, 3.9% and 5.7% respectively against the US dollar, euro and yen. The depreciation of sterling against its major counterparts was driven by safe haven demand which lifted the dollar and the unwinding of leveraged currency positions which bolstered the euro and the yen. The rise in the yen over the quarter erased most of its depreciation over the last 12 months.

Commodity Market Review

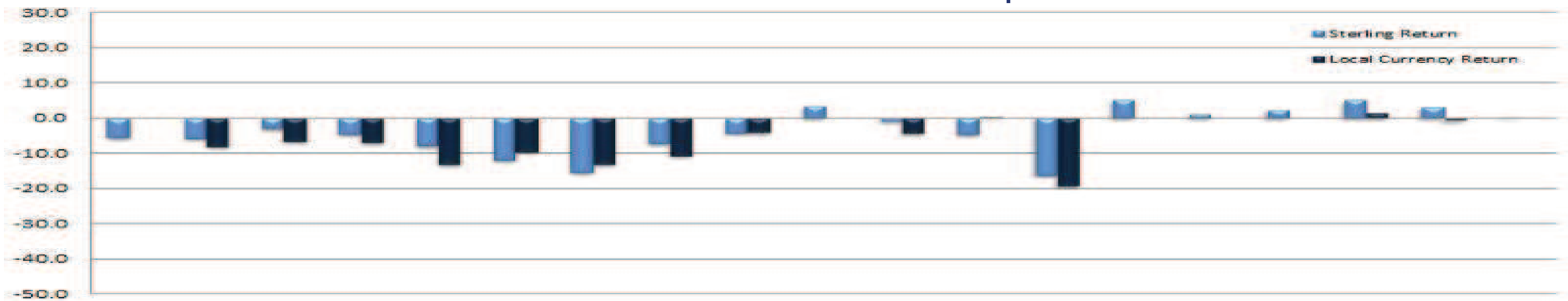
Energy prices led commodity prices lower, returning -24.4% over the quarter, as oil prices reached a six year low in August 2015 on the back of increased stockpiles in the United States and concerns that a slowing Chinese economy would adversely impact global demand.

Gold prices fell over the period by 4.7%. The negative price impact from the stronger Dollar was partially offset by safe haven demand on the back of increased global market volatility.

Source: Thomson Reuters Datastream.

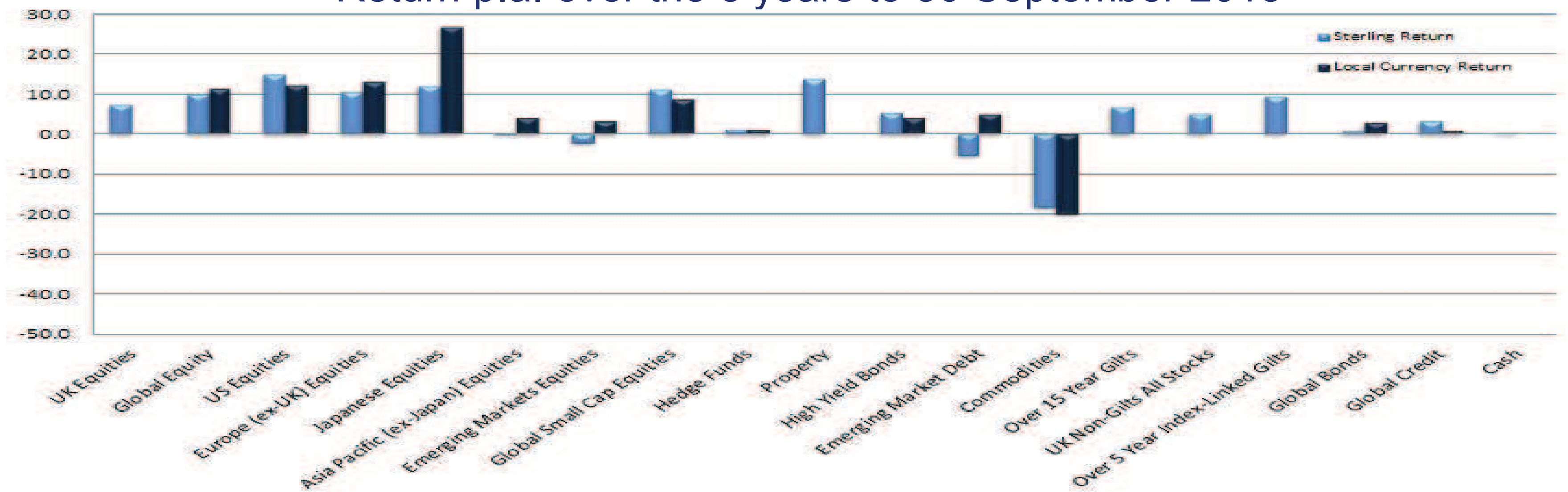
MARKET BACKGROUND
INDEX PERFORMANCE

Return over the 3 months to 30 September 2015



Return over the 12 months to 30 September 2015

Return p.a. over the 3 years to 30 September 2015



Source: Thomson Reuters Datastream.

SECTION 3
STRATEGIC CONSIDERATIONS

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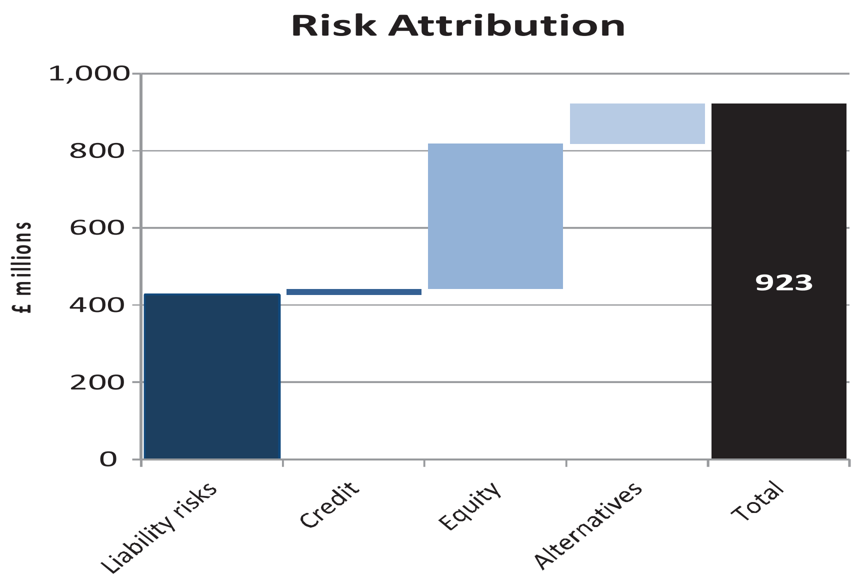
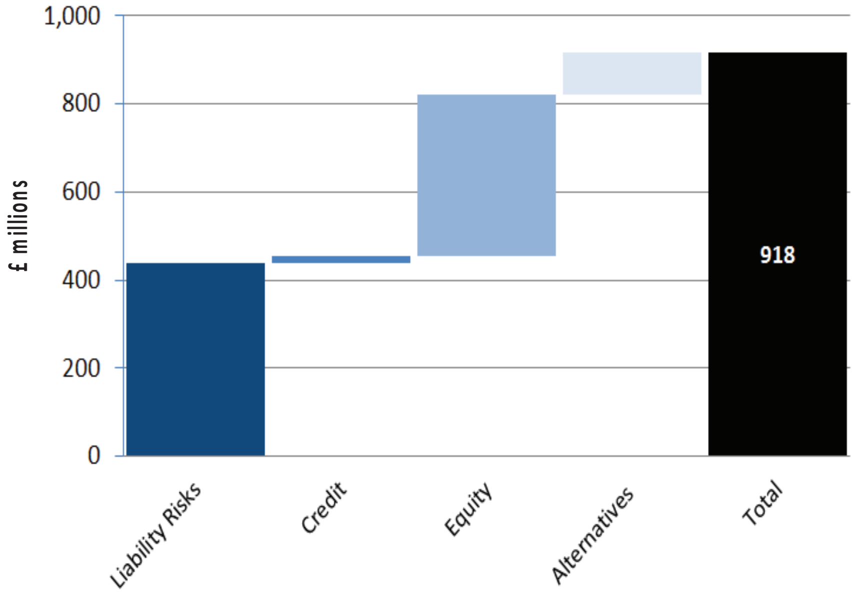
STRATEGIC CONSIDERATIONS
RISK DECOMPOSITION

30 June 2015



30 September 2015



The two charts to the left illustrate not only the main risks the Fund is exposed to (which is why the funding position is volatile) but also the size of these risks in the context of the change in the deficit position.

The purpose of showing these charts is not to alarm, rather to ensure there is an awareness of the risks faced and how they change over time and to initiate debate on an ongoing basis, around how to best manage these risks, so as not to lose sight of the “big picture”.

The black column on the right hand side of each chart shows the estimated 95th percentile Value at Risk figure over a one-year period. In other words, if we consider a downside scenario which has a 1 in 20 chance of occurring, what would be the impact on the deficit relative to our “best estimate” of what the deficit would be in one years time.

If we focus on the chart at 30 September 2015, the chart shows that if a 1 in 20 “downside event” occurred, we would expect that in one year’s time, the deficit would increase by an additional **£918m** on top of the current deficit of **£1.4b**, creating a deficit of **£2.3b**.

Each bar to the left of the black bar represents the contribution to this total risk from the primary underlying risk exposures (interest rates and inflation, changes in credit spreads and volatility of equity markets and alternative assets).

The two charts show that the one-year risk over the quarter has stayed broadly the same, with a slight change of c£5m from **£923m** to **£918m**. This slight reduction is due to the size of the assets reducing, decreasing their contribution to total risk. This was slightly offset by the increase in the Fund’s liabilities over the quarter.

The contributions to the total risk from the various return drivers have, as expected, changed little. Liability risks (i.e. interest rate) and equity market risk dominate.

The VaR figures shown are based on approximate liability data rather than actual Fund cashflows, and are based on the strategic asset allocation. They are therefore illustrative only and should not be used as a basis for taking any strategic decisions.

MARKET BACKGROUND
INDEX PERFORMANCE VERSUS STRATEGY

Asset Class	Strategy Assumed Return % p.a.	3 year Index Return % p.a.	Comment
Developed Equities (Global) (FTSE All-World Developed)	8.25	11.3	*Remains significantly ahead of the assumed strategic return.* *This has decreased from 14.6% p.a. last quarter as the latest quarter's return of -4.8% was lower than the 3.9% return of Q3 2012, which fell out of the 3 year return.*
Emerging Market Equities (FTSE AW Emerging)	8.75	-2.2	*The 3 year return from emerging market equities has fallen from 5.0% p.a. last quarter, driven by a negative return of -15.6% experienced last quarter, which was considerably lower than the quarter that fell out (+4.6%). The 3 year return remains below the assumed strategic return.*
Diversified Growth	Libor + 4% / RPI + 5%	4.5 / 7.1	*DGFs are expected to produce an equity like return over the long term but with lower volatility – this is the basis for the Libor and RPI based benchmarks. Low cash rates means that the Libor based benchmark has significantly underperformed the inflation (RPI) based benchmark and the long term expected return from equity. During periods of strong equity returns, such as the recent three year period, we would expect DGF to underperform equities.*
UK Gilts (FTSE Actuaries Over 15 Year Gilts)	4.5	6.7	*UK gilt returns remain above the long term strategic assumed return as yields remain depressed relative to historic averages. Returns have increased compared to the previous quarter as a result of the fall in yields (and hence negative total returns) experienced in the last quarter. On the other hand, corporate bond returns have reduced this quarter, and looking back over three years are now below the strategic assumed return.*
Index Linked Gilts (FTSE Actuaries Over 5 Year Index-Linked Gilts)	4.25	9.4	
UK Corporate Bonds (BofAML Sterling Non Gilts)	5.5	5.1	
Overseas Fixed Interest (JP Morgan Global Government Bonds ex UK)	5.5	-0.6	*The 3 year performance remains in negative territory despite positive returns this quarter as a result of the fall in global bond yields.*
Fund of Hedge Funds (HFRX Global Hedge Fund Index)	6.0	1.3	*Hedge fund returns remain below long term averages and the strategic return, as they are affected by low cash rates. Volatility remains low but recent returns have improved slightly given signs of volatility emerging.*
Property (IPD UK Monthly)	7.0	13.7	*Property returns continue to be above the expected returns, driven by the economic recovery in the US and the UK.*

Source: Thomson Reuters Datastream.

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q4 2015

- Extremely Unattractive
- Unattractive
- Neutral
- Attractive
- Extremely Attractive

Mercer's current DAA position/view

Position/view last time (if changed)

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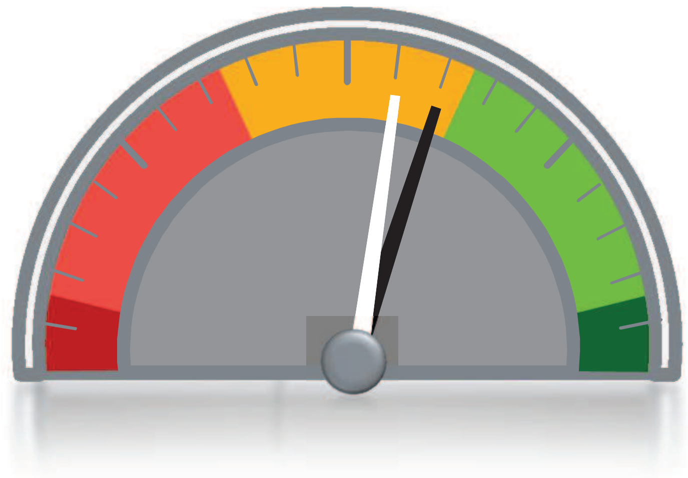

DEVELOPED MARKET EQUITIES

- Monetary policies remain generally supportive of equity markets
- Valuations have fallen closer to historical averages following price deterioration
- Slowdown in global growth has led to a deterioration in market sentiment and increased volatility

EMERGING MARKET EQUITIES

- Valuations significantly below long-term averages, though vary by region and country
- Decline in investor sentiment with added uncertainty over prospect of a Fed rate rise
- Interrelated headwinds include slowing Chinese growth, weak commodity prices and risk of further currency depreciation

These charts summarise Mercer's views on the medium term outlook for returns from the key asset classes; by medium term we mean one to three years. These views are relevant for reflecting medium term market views in determining appropriate asset allocation. We do not expect investors to make frequent tactical changes to their asset allocation based upon these views. These are also based from the view of an absolute return investor, and so do not take into account pension scheme liabilities.

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q4 2015

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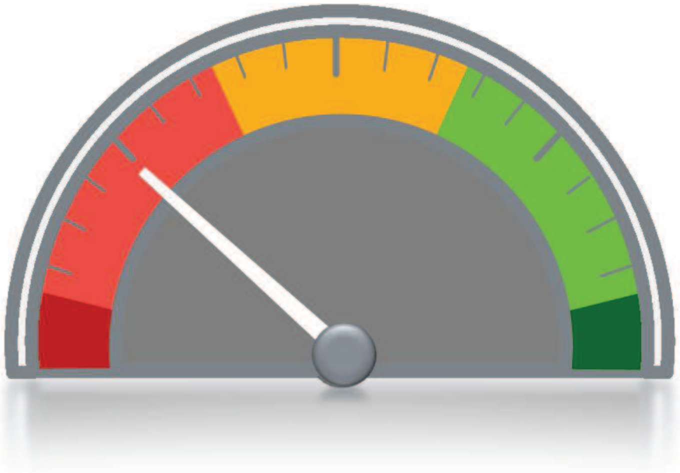

FIXED INTEREST GILTS (ALL STOCK)

- ✓ Ongoing extraordinary monetary policy continues to restrain yield moves
- ! Disappointing growth and inflation data reports led to long dated yields drifting lower over the quarter
- ! Eventual policy rate hikes in the US could hurt performance of fixed income assets

INDEX-LINKED GILTS

- ✓ Real yields have remained broadly stable over the quarter despite a decline in nominal yields
- ✓ Breakeven inflation has fallen to cyclical lows
- ! Real yields remain historically low

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q4 2015

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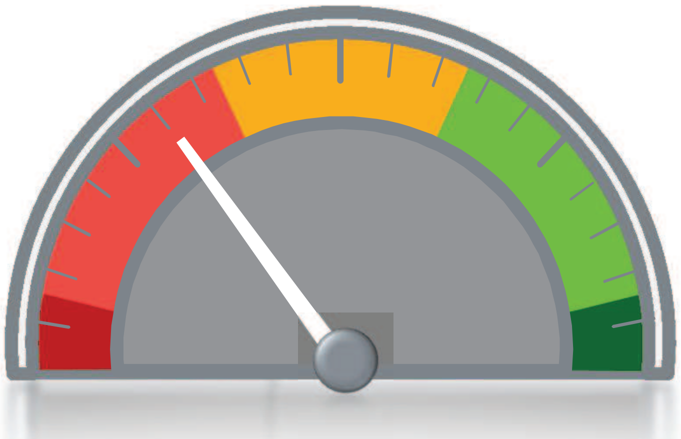
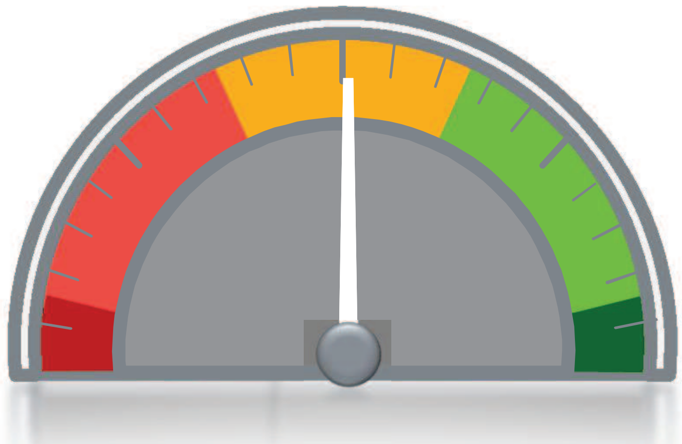


NON-GOVERNMENT BONDS (£ ALL-STOCK)

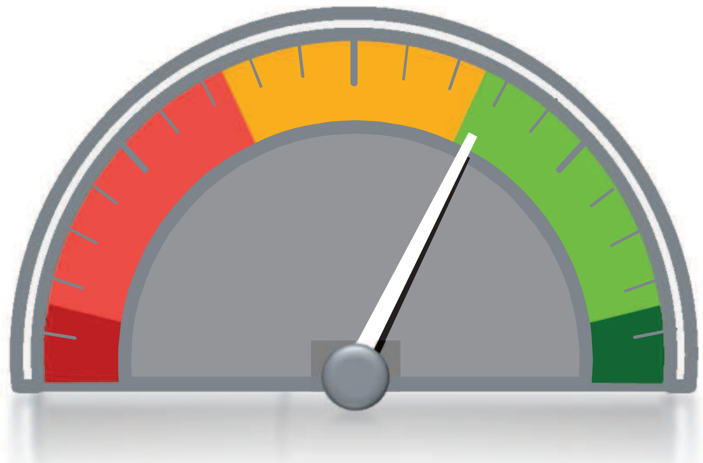
- Credit spreads have increased over the quarter and provide reasonable compensation against current default rates
- ! Credit yields remain historically low and prospective returns are limited
- ! Lack of trading liquidity has led to risk of increased volatility in credit markets



UK PROPERTY

- Yields look reasonable relative to other assets, despite a small decrease in Q3
- Supply side imbalances remain with regions outside London starting to see a pickup in rental growth
- ! Cautious of opportunistic strategies, and of London market over-heating

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q4 2015



GROWTH VERSUS DEFENSIVE

Asset Class	April 2015	July 2015	Oct 2015
Fixed Interest Gilts	Unattractive	Unattractive	Unattractive
Index-Linked Gilts	Unattractive	Unattractive	Unattractive
Eurozone Government Bonds	Extremely Unattractive	Unattractive	Unattractive
Non-Government Bonds (£ All-Stocks)	Unattractive	Unattractive	Unattractive
Non-Government Bonds (€ All-Stocks)	Extremely Unattractive	Unattractive	Unattractive
Global Equities	Neutral	Neutral	Neutral
Emerging Market Equities	Neutral	Neutral	Neutral
Small Cap Equities	Neutral	Neutral	Neutral
Low Volatility Equities	Neutral	Neutral	Neutral
UK Property	Neutral	Neutral	Neutral
High yield bonds	Neutral	Neutral	Neutral
Local currency emerging market debt	Neutral	Neutral	Unattractive

SECTION 4
CONSIDERATION OF FUNDING LEVEL

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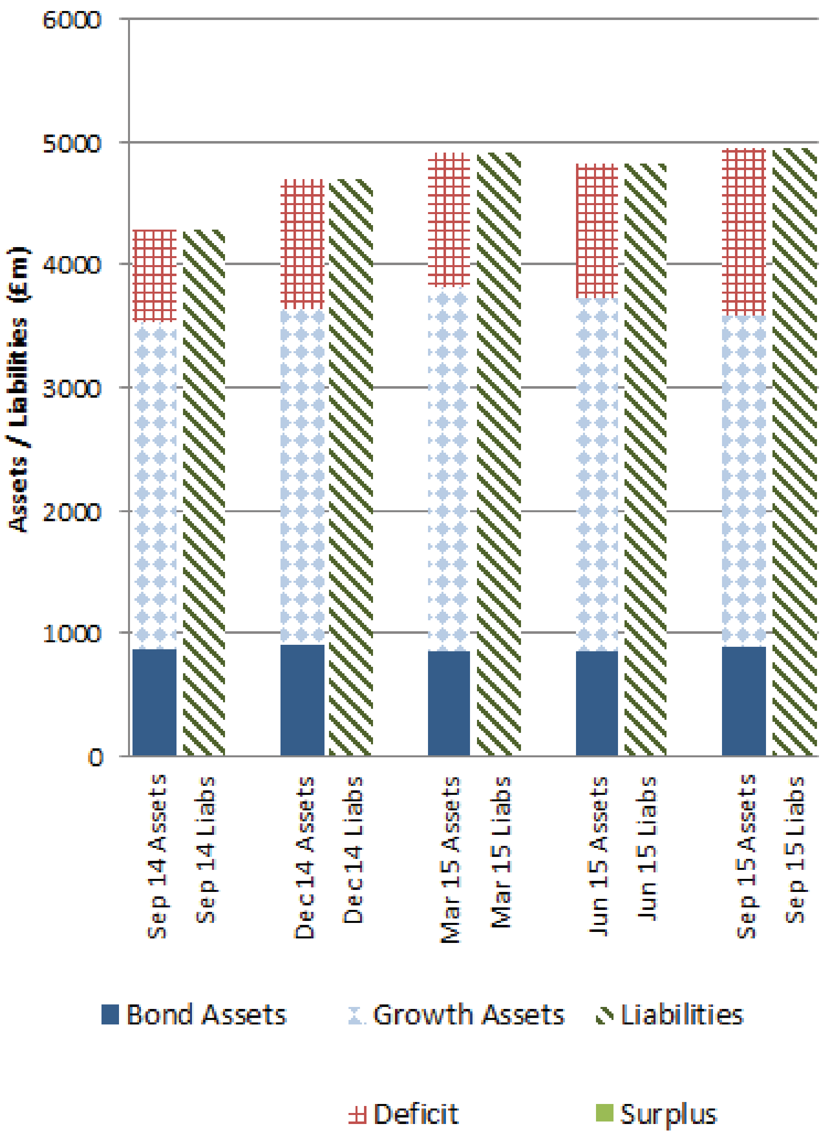
ASSET ALLOCATION AND FUNDING LEVEL



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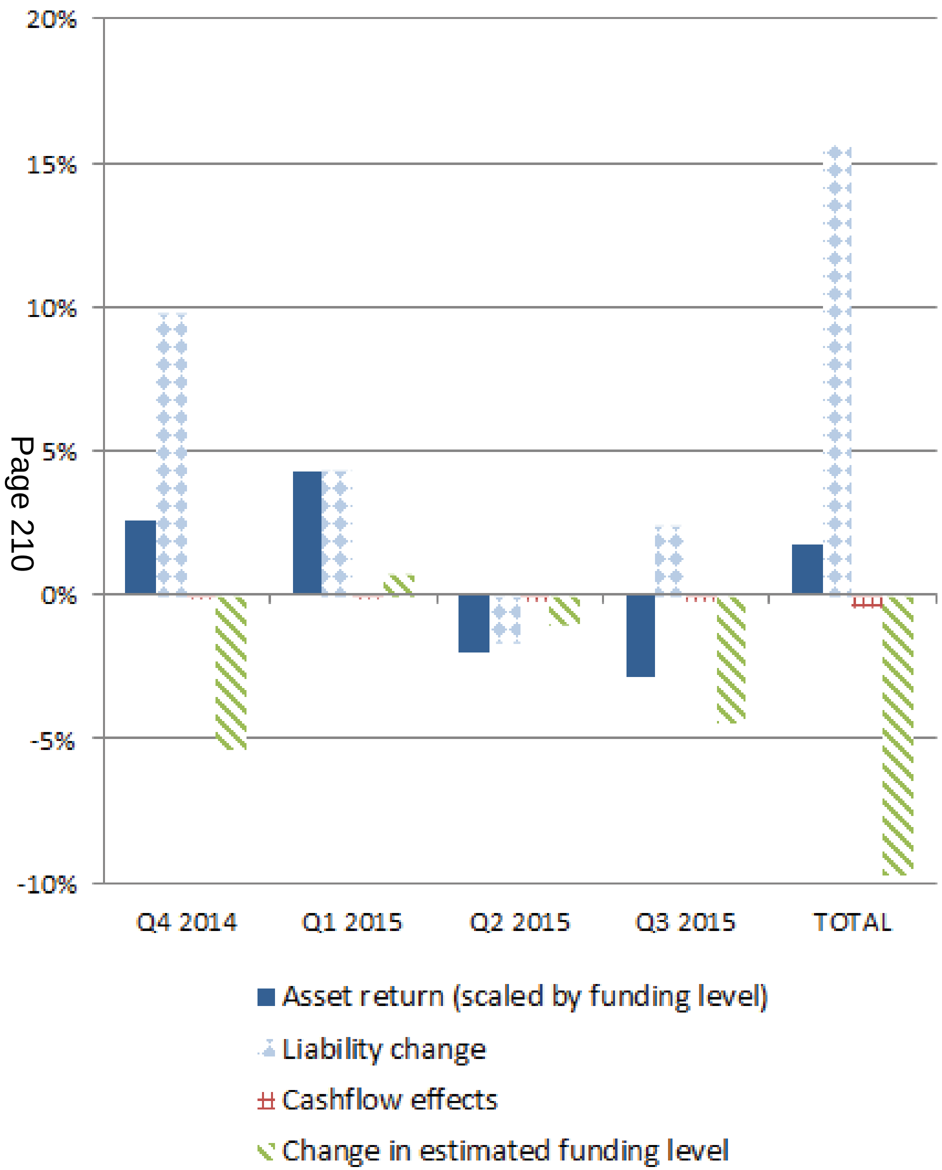
- Based on financial markets, investment returns and cashflows into the Fund, the estimated funding level decreased by c. 4% over the third quarter of 2015, all else being equal, from 77% to 73%. This was driven by:
  - A negative asset return from most of the growth asset classes;
  - A negative effect from the liabilities, as the discount rate decreased, increasing the value placed on the liabilities (somewhat offset by a decrease in the inflation assumption used to value inflation-linked liabilities).
- At the valuation date, 31 March 2013, the Scheme was 78% funded. Since then financial market movements, actual cashflows, and investment returns are expected to have decreased the overall funding level to 73%. This reduction has come mainly from the increase in the present value of the liabilities over the period (due to the falling discount rate).

CONSIDERATION OF FUNDING LEVEL
FUND PERFORMANCE RELATIVE TO ESTIMATED LIABILITIES



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- The Fund's assets returned -3.6% over the quarter, which, when allowing for the funding position, reduced the funding level by 2.9%.
- However, the Fund's estimated liabilities increased by 2.5% (primarily due to a decrease in the discount rate, offset to some extent by a decrease in the inflation assumption used to value inflation-linked liabilities and accruing benefits).
- Over this quarter, the "cashflow effect" from contributions was negligible.
- Overall, the combined effect has led to a decrease in the estimated funding level to 73% (from 77% at 30 June 2015).
- Over the 12 month period, the funding level has fallen by 10% primarily due a fall in yields.

SECTION 5
FUND VALUATIONS

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FUND VALUATIONS
VALUATION BY ASSET CLASS

Asset Allocation

Asset Class	Start of Quarter (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)	Target Strategic Benchmark (%)	Ranges (%)	Difference (%)
Developed Market Equities	1,700,572	1,568,521	45.6	43.6	40.0	35 - 45	+3.6
Emerging Market Equities	333,534	293,957	8.9	8.2	10.0	5 - 15	-1.8
Diversified Growth Funds	362,564	357,914	9.7	9.9	10.0	5 - 15	-0.1
Fund of Hedge Funds	162,952	157,291	4.4	4.4	5.0	0 - 7.5	-0.6
Property	314,626	327,832	8.4	9.1	10.0	5 - 15	-0.9
Infrastructure	-	-	-	-	5.0	0 - 7.5	-5.0
Bonds	759,781	761,311	20.4	21.1	20.0	15 - 35	+1.1
Cash (including currency instruments)	96,070	133,923	2.6	3.7	-	0 - 5	+3.7
Total	**3,730,099**	**3,600,749**	**100.0**	**100.0**	**100.0**		**0.0**

Source: WM Performance Services, Mercer. Green numbers indicate the allocation is within tolerance ranges, whilst red numbers indicate the allocation is outside of tolerance ranges.

Invested assets decreased over the quarter by £129m due to negative returns across major asset classes. At the start of the quarter, developed equities were overweight relative to benchmark (and outside the range in the SIP); at 30 September 2015 they remained overweight but within the agreed tolerance ranges. This overweight will be further reduced when funds are drawn down to fund the infrastructure investments.

FUND VALUATIONS
VALUATION BY MANAGER

Manager Allocation						
Manager	**Asset Class**	**Start of Quarter (£'000)**	**Cashflows (£'000)**	**End of Quarter (£'000)**	**Start of Quarter (%)**	**End of Quarter (%)**
BlackRock	Passive Multi-Asset	1,155,704	-40,000	1,099,762	31.0	30.5
Jupiter	UK Equities	178,108	-	168,771	4.8	4.7
TT International	UK Equities	198,482	-	193,736	5.3	5.4
Schroder	Global Equities	242,720	-	232,442	6.5	6.5
Genesis	Emerging Market Equities	152,092	-	132,393	4.1	3.7
Unigestion	Emerging Market Equities	181,442	-	161,564	4.9	4.5
Invesco	Global ex-UK Equities	273,939	-	260,036	7.3	7.2
SSgA	Europe ex UK & Pacific inc. Japan Equities	118,061	-	109,756	3.2	3.0
Record Currency Management	Overseas Equities (to fund currency hedge)	34,093	-	3,430	0.9	0.1
Pyrford	DGF	121,530	-	120,916	3.3	3.4
Standard Life	DGF	241,035	-	236,999	6.5	6.6

Source: WM Services, Avon. Totals may not sum due to rounding.

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FUND VALUATIONS
VALUATION BY MANAGER

Manager Allocation

Manager	Asset Class	Start of Quarter (£'000)	Cashflows (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
MAN	Fund of Hedge Funds	549	-	593	0.0	0.0
Signet	Fund of Hedge Funds	63,153	-22,611	38,877	1.7	1.1
Stenham	Fund of Hedge Funds	39,745	-39,927	-	1.1	-
Gottex	Fund of Hedge Funds	59,505	-	58,405	1.6	1.6
JP Morgan*	Fund of Hedge Funds	-	59,879	59,416	-	1.7
Schroder	UK Property	183,792	-	189,410	4.9	5.3
Partners	Property	140,391	-	150,487	3.8	4.2
RLAM	Bonds	298,655	-20,000	281,004	8.0	7.8
Internal Cash	Cash	47,103	62,659	102,710	1.3	2.9
Total		**3,730,099**	**-**	**3,600,749**	**100.0**	**100.0**

Source: WM Services, Avon. Totals may not sum due to rounding.
* £59,611k tranche to be invested on 1 October included in cash.

SECTION 6
PERFORMANCE SUMMARY

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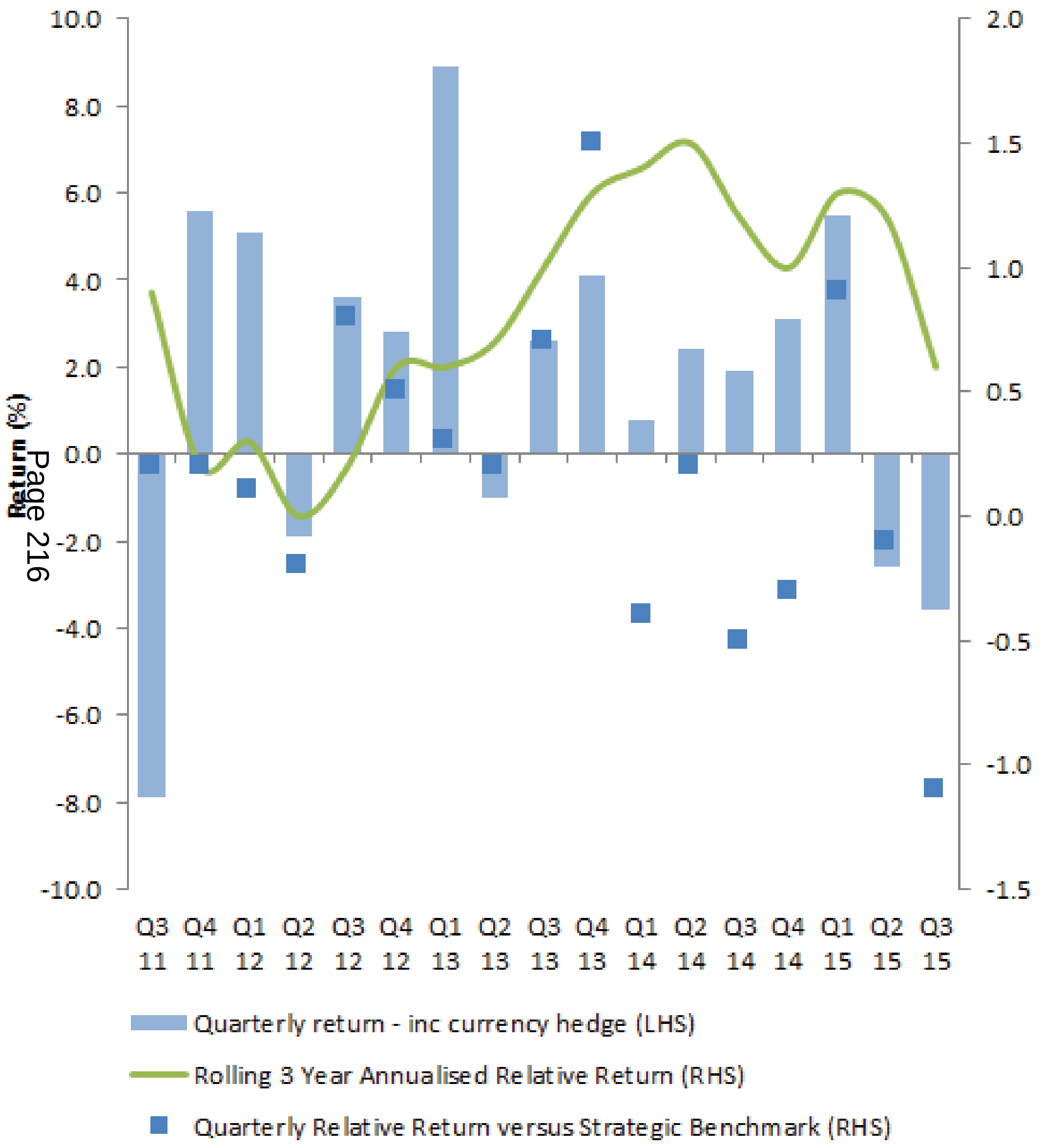
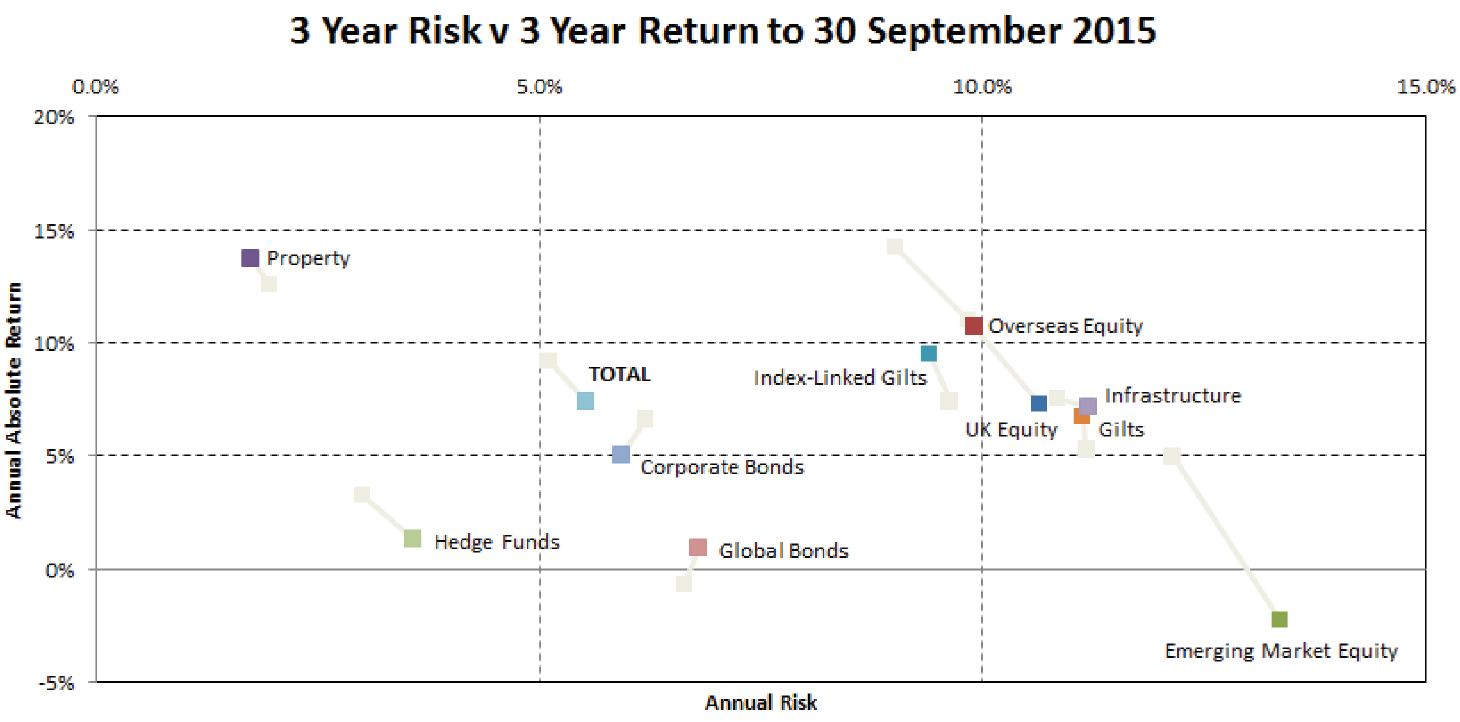
PERFORMANCE SUMMARY
TOTAL FUND PERFORMANCE



	3 months (%)	1 year (%)	3 years (% p.a.)
Total Fund (inc currency hedge)	-3.6	2.2	8.3
Total Fund (ex currency hedge)	-2.8	2.5	8.3
Strategic Benchmark (no currency hedge)	-2.5	2.8	7.7
Relative (inc currency hedge)	**-1.1**	**-0.6**	**+0.6**

- Over Q3 2015, the Fund underperformed its Strategic Benchmark by 1.1% when including the currency hedge, and by 0.3% excluding the currency hedge.
- The Fund has underperformed the Strategic Benchmark over the year by 0.6% but outperformed over the three year period by 0.6% p.a.
- The latest quarter's underperformance has reduced the rolling three year outperformance from 1.2% p.a. to 0.6% p.a.
- The underperformance of the Fund over the quarter was largely due to the overweight position in overseas equities (which produced negative returns over the quarter) and the underweight position in hedge funds, the underperformance of the DGFs relative to their cash benchmark and the depreciation of sterling (which led to negative returns when the currency hedge with Record is included).



This chart shows the 3 year absolute returns against three year volatility (based on monthly data in sterling terms), to the end of September 2015, for each of the broad underlying asset benchmarks (using the indices set out in the Appendix), along with the total Fund strategic benchmark (using the benchmark indices and allocations from WM Services). We also show the positions as at last quarter, in grey.

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Comments

- *The most significant movement seen over the quarter was emerging market equity, which saw a significant decrease in three-year trailing return, driven by Latin American and Asian economies (with similar – albeit less pronounced – movements seen for UK and overseas equities).*
- *Index-linked gilts and property saw absolute returns rise and experienced volatility fall over the quarter.*

MANAGER MONITORING
RISK RETURN ANALYSIS

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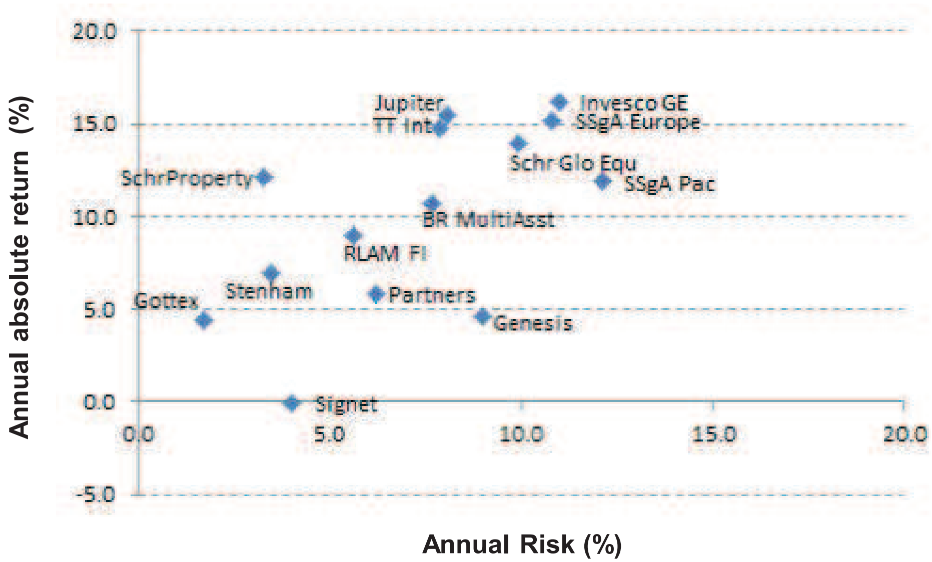
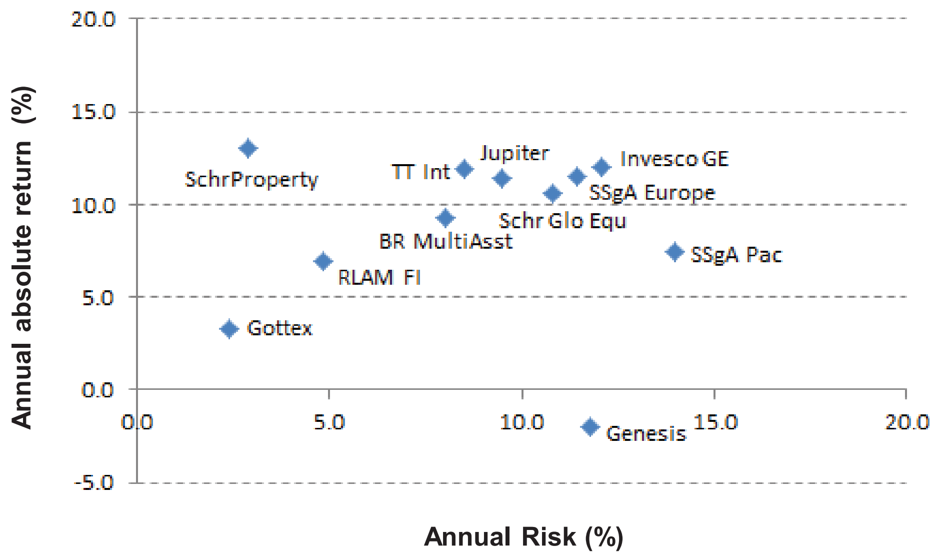
3 year Risk vs 3 year Return to 30 June 2015



3 year Risk vs 3 year Return to 30 September 2015



Comments

- *In general absolute returns of the funds decreased over the quarter, whilst volatility increased. Genesis was the fund where this impact was most noticeable given the significantly negative returns delivered by emerging market equities.*

MANAGER MONITORING
MANAGER PERFORMANCE – RELATIVE RETURNS TO BENCHMARK (TO 30 SEPTEMBER 2015)

Manager / fund	3 months (%)	1 year (%)	3 years (% p.a.)	3 year versus performance target
BlackRock Multi-Asset	0.1	0.1	0.2	Target met
Jupiter	0.5	5.5	4.0	Target met
TT International	3.5	7.8	4.5	Target met
Schroder Equity	1.7	3.4	0.8	Target not met
Genesis	1.7	-0.9	0.9	Target met
Unigestion	4.3	0.7	NA	NA
Invesco	-0.3	-0.2	0.5	Target met
SSgA Europe	1.0	0.9	0.8	Target met
SsgA Pacific	0.5	1.1	1.3	Target met
Pyrford	-1.7	-3.3	NA	NA
Standard Life	-3.2	NA	NA	NA
Signet*	-2.0	-9.0	-3.6	Target not met
Gottex	-2.7	-4.3	-0.5	Target not met
JP Morgan	NA	NA	NA	NA
Schroder Property	0.1	-0.6	1.2	Target met
Partners Property*	-1.8	-11.5	-3.2	Target not met
RLAM	-0.1	0.4	1.9	Target met
Internal Cash	0.0	0.0	0.1	NA

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Source: WM Services, Avon.
Returns in blue text exceeded their respective benchmarks, those in red underperformed, and black text shows performance in line with benchmark.
In the table above, and throughout this report, relative returns have been calculated geometrically (i.e. the portfolio return is divided by the benchmark return) rather than arithmetically (where the benchmark return is subtracted from the portfolio return).
* Performance shown to 30 June 2015 as data to 30 September 2015 was unavailable at the time of writing.

APPENDIX 1
SUMMARY OF MANDATES

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SUMMARY OF MANDATES

Manager	Mandate	Benchmark	Outperformance target (p.a.)
Jupiter Asset Management	UK Equities (Socially Responsible Investing)	FTSE All Share	+2%
TT International	UK Equities (Unconstrained)	FTSE All Share	+3-4%
Schroder	Global Equities (Unconstrained)	MSCI AC World Index Free	+4%
Genesis	Emerging Market Equities	MSCI EM IMI TR	-
Unigestion	Emerging Market Equities	MSCI EM NET TR	+2-4%
Invesco	Global ex-UK Equities (Enhanced Indexation)	MSCI World ex UK NDR	+0.5%
SSgA	Europe ex-UK Equities (Enhanced Indexation)	FTSE AW Europe ex UK	+0.5%
SSgA	Pacific inc. Japan Equities (Enhanced Indexation)	FTSE AW Dev Asia Pacific	+0.5%
Record	Active Currency Hedging	N/A	-
Pyrford	Diversified Growth Fund	RPI +5% p.a.	-
Standard Life	Diversified Growth Fund	3 Month LIBOR +5% p.a.	-
Signet	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-
Gottex	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-
JP Morgan	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-
Schroder	UK Property	IPD UK Pooled	+1%
Partners	Overseas Property	IPD Global Pooled	+2%
Royal London Asset Management	UK Corporate Bonds	iBoxx £ Non-Gilts All Maturities	+0.8%
BlackRock	Passive Multi-Asset	In line with customised benchmarks using monthly mean fund weights	-
Cash	Internally Managed	7 Day LIBID	-

APPENDIX 2
MARKET STATISTICS INDICES

MARKET STATISTICS INDICES

Asset Class	Index
UK Equities	FTSE All-Share
Global Equity	FTSE All-World
Overseas Equities	FTSE World ex UK
US Equities	FTSE USA
Europe (ex-UK) Equities	FTSE W Europe ex UK
Japanese Equities	FTSE Japan
Asia Pacific (ex-Japan) Equities	FTSE W Asia Pacific ex Japan
Emerging Markets Equities	FTSE AW Emerging
Global Small Cap Equities	FTSE World Small Cap
Hedge Funds	HFRX Global Hedge Fund
High Yield Bonds	BofA Merrill Lynch Global High Yield
Emerging Market Debt	JP Morgan GBI EM Diversified Composite
Property	IPD UK Monthly Total Return: All Property
Commodities	S&P GSCI
Over 15 Year Gilts	FTA UK Gilts 15+ year
Sterling Non Gilts	BofA Merrill Lynch Sterling Non Gilts All Stocks
Over 5 Year Index-Linked Gilts	FTA UK Index Linked Gilts 5+ year
Global Bonds	BofA Merrill Lynch Global Broad Market
Global Credit	Barclays Capital Global Credit
Eurozone Government Bonds	BofA Merrill Lynch EMU Direct Government
Cash	BofA Merrill Lynch United Kingdom Sterling LIBOR 3 month constant maturity

These are the indices used in this report for market commentary; individual strategy returns are shown against their specific benchmarks.

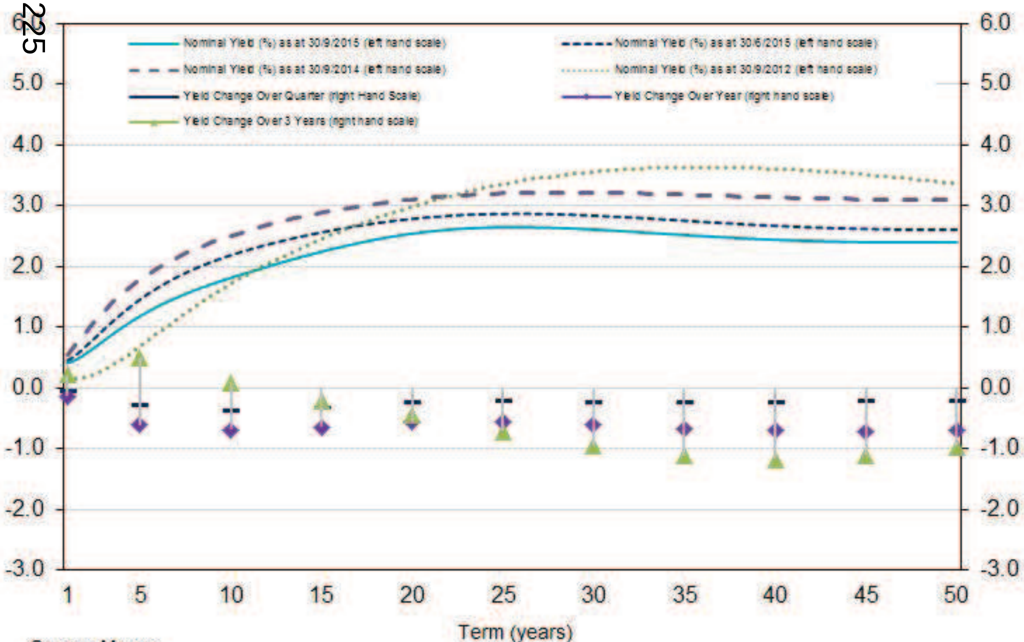
APPENDIX 3
CHANGES IN YIELDS

CHANGES IN YIELDS

Asset Class Yields (% p.a.)	30 September 2015	30 June 2015	30 September 2014	30 September 2013
UK Equities	3.71	3.46	3.34	3.41
Over 15 Year Gilts	2.38	2.63	2.98	3.41
Over 5 Year Index-Linked Gilts	-0.83	-0.75	-0.35	-0.02
Sterling Non Gilts	3.16	3.15	3.39	3.64

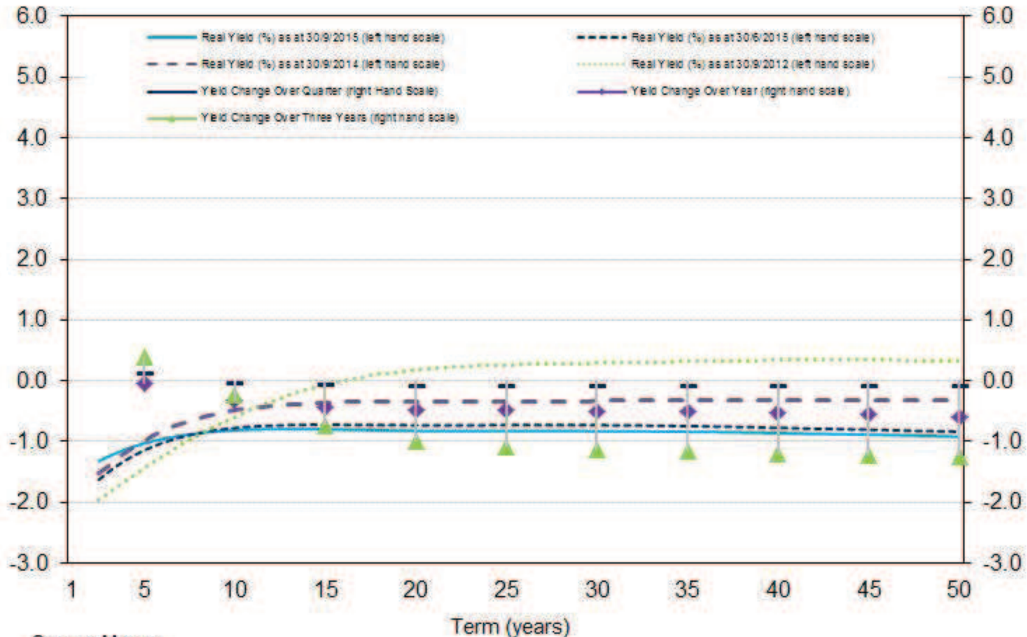
- After a sharp rise during the second quarter of the year, bond yields fell across all maturities over the quarter, resulting in positive returns for investors.
- Nominal gilt yields decreased across all maturities during the third quarter, resulting in a return of 5.1% for Over 15 Year Gilts Index.
- The real yield curve also moved down, although by less than nominal yields, resulting in a degree of normalization of previously depressed breakeven inflation rates. Index-linked gilts posted a quarterly gain of 2.3%, as measured by the Over 5 year Index-Linked Gilts index.
- The total returns from global credit rose by 3.0% in the third quarter in Sterling terms, with a moderate loss of 0.8% in local currency terms, with a moderate loss of 0.8% in local currency terms. Credit spreads widened slightly in the UK, but yields still fell overall, resulting in a 1.0% total return on All Stocks UK corporate bonds.

Nominal yield curves.



Source: Mercer.

Real yield curves.



Source: Mercer.

MAKE
TOMORROW,
TODAY

MERCER

QUARTERLY ENGAGEMENT REPORT

JULY TO SEPTEMBER 2015

Local Authority Pension Fund Forum

The Local Authority Pension Fund Forum (LAPFF) exists to promote the investment interests of member funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at companies in which they invest. Formed in 1990, LAPFF brings together a diverse range of local authority pension funds in the UK with combined assets of over £175 billion.

ACHIEVEMENTS

- Building on its previous success in demonstrating that the **accounting standards** used by many UK companies are not consistent with the legal requirement of a 'true and fair view' of accounts, LAPFF has obtained a second opinion on this topic from Mr George Bompas QC. Mr Bompas argued in his first opinion that financial statements must give a 'true and fair view' of accounts in line with UK company law that cannot be overridden by accounting standards. This latest opinion, released publicly on 1 September 2015, goes to the heart of the matter in confirming that UK law requires accounts to be properly prepared in order to determine what capital is available for the purpose of distributing dividends.

- Properly prepared accounts are those that 'enable a determination of what is or is not available for distribution by reference to amounts stated in them.' As a result, 'resort to further supplementary records or documents' is neither required nor permitted to determine what is available for distribution. In other words, companies can only issue dividends on realised, as opposed to unrealised, profits.

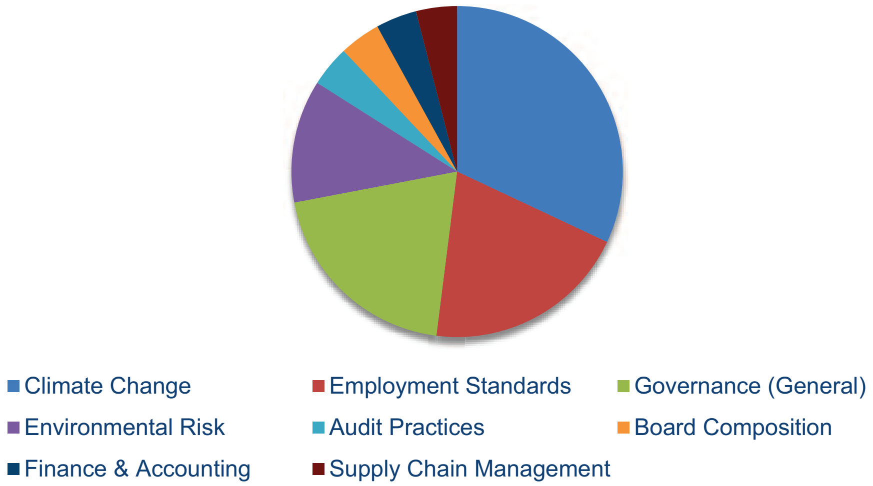
- Mr Bompas' second opinion has received immediate attention from the financial press, with the Financial Times publishing an emphatic piece that describes the opinion as 'potentially explosive.' The FT piece further makes the point that while regulations on capital requirements and boardroom standards have been amended significantly in the wake of the financial crisis, needed amendments have not yet been made to accounting standards. This observation is helpful as LAPFF continues its efforts to push for accounting standards that comply with the law and allow for integrity of the financial system. Subsequent to this, meetings were held with RBS, HSBC and Barclays to discuss the implications of the second Bompas opinion for their accounts.

- LAPFF Executive member, Geik Drever, attended the **National Grid** Annual General Meeting, to ask the board how climate change strategy is shaping the Company's overall business strategy and whether the Company plans to disclose its Scope 3 emissions. LAPFF asked about Scope 3 emissions at last year's National Grid AGM and was told it was the first investor group to do so. It was therefore gratifying to hear that the Company is likely to disclose its Scope 3 emissions starting next year.

- LAPFF participated in an Equality and Human Rights Commission Inquiry roundtable into the recruitment and appointment of board directors. The appointment of women to boards was of particular interest during the roundtable discussion. Cllr Mary Barnett represented LAPFF at the Inquiry.

COMPANY ENGAGEMENT

ENGAGEMENT TOPICS

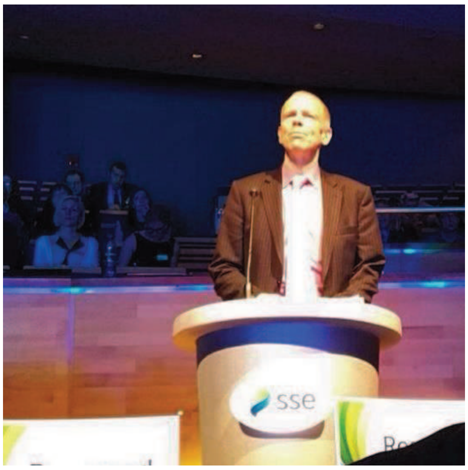


HOLDINGS BASED ENGAGEMENT

Cllr Denise Le Gal attended the **BT Group** AGM and spoke to the chairman, Sir Michael Rake, to welcome: the introduction of clawback provisions in remuneration; the achievement of a gender diverse board; and the significant carbon emission reductions made during the year. She noted the company auditors had been in place for thirty one years and set out that auditor rotation reduces the risks of excessive familiarity between statutory auditors and clients, encourages fresh thinking and helps limit conflicts of interest.

LAPFF attended the **Vodafone** AGM for the second year in a row. Chairman Gerard Kleisterlee presided over the meeting. The Forum asked about board and auditor independence. Specifically, the new Senior Independent Director, Philip Yea, has worked as recently as 2014 with the Company's auditors, so LAPFF asked why, given this apparent conflict of interest, the Company took the decision to appoint Mr Yea as Senior Independent Director. LAPFF raised this concern with Vodafone last year when Mr Yea was appointed to chair the Audit Committee. This topic is likely to gain publicity as European law on auditor rotation and independence come into force and raise visibility of the role of auditors. LAPFF has already asked about auditor rotation and independence at a number of AGMs, and companies appear to have varying states of preparation in answering these questions. While they might be prepared from a legal perspective, they often do not satisfy investor concerns in this area.

In July, LAPFF Executive Member, Cllr Cameron Rose, attended the **SSE** AGM in Perth, Scotland. In line with the above concerns about legal developments surrounding independent auditors, Cllr Rose asked about auditor independence at the meeting where Lord Smith of Kelvin stepped aside to make way for new chairman, Richard Gillingwater. Mr Gillingwater indicated his satisfaction with the independence of the current auditor. SSE is required to rotate its auditor in 2021, but will run a tender process in 2018 for a 2019 rotation. The response to a second question on carbon capture and storage was that SSE is confident that CCS will go forward with UK government approval.



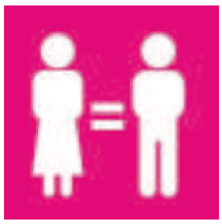
PROMOTING GOOD GOVERNANCE

LAPFF Chairman, Cllr Kieran Quinn, met again with **Trinity Mirror Group** Chairman, David Grigson, to discuss the company's strategy and progress on dealing with phone hacking claims. The Company seems to have taken LAPFF suggestions on board and is taking positive steps to resolve challenges, both in relation to strategy and hacking.

Tax expert, Richard Murphy, has analysed company responses to the **Corporate Tax Transparency Initiative** (CTTI) survey sent by LAPFF to the FTSE 100 earlier in the year. His summary report suggests a continued reluctance by many companies to engage on this issue, but there are particular areas that some major companies have identified that suggest possible ways forward to progress corporate tax transparency.

PEOPLE AND INVESTMENT VALUE/EMPLOYMENT STANDARDS

Cllr Mary Barnett attended a roundtable inquiry hosted by the Equality and Human Rights Commission (EHRC) on FTSE 350 recruitment and appointment of board directors. The roundtable was an evidence-gathering exercise and an opportunity for the EHRC to share some emerging issues and findings on board appointments. One area addressed was the challenges faced in improving the representation of women on boards.



The 30% Club Investor Group, of which LAPFF is a member, has responded to the Government Equality Office's Gender Pay Gap consultation which strongly supports publication of gender pay information to encourage employers to take action to help close this gap.

LAPFF has also co-signed a letter to support the **Business Supply Chain Transparency on Trafficking and Slavery Act of 2015** being proposed at the federal level in the United States. This bill follows on from almost identical legislation already in place in California that requires businesses of a certain size to report on their supply chain practices in relation to trafficking and slavery.

Cllr Richard Greening spoke to the company secretary at **John Menzies** about health and safety practices in light of worker deaths at Los Angeles International Airport. The Company had been the target of a vigorous union campaign to improve its health and safety practices after a Menzies worker died while driving a baggage tug. John Geddes spoke openly with Cllr Greening about what the Company learned from the experience and how it has taken steps to improve its health and safety programme for workers. Mr Geddes also spoke about the Company's experience of working with unions in this context. Separately, Cllr Greening spoke about how LAPFF engages on the issue of worker rights at the Committee on Workers Capital conference.

A meeting with **Halfords** explored the link between how employees are treated by the companies they work for and the value that companies create for shareholders in the context of Halfords' approach to employee engagement.

ENERGY, CARBON AND ENVIRONMENTAL RISK MANAGEMENT

LAPFF continued its engagement on carbon management with **Shell** and **BP** following the unprecedented support by the boards for the strategic resilience resolutions put to their AGMs. These were overwhelmingly passed by shareholders with votes of over 98% at both meetings. The Forum continues its membership of the Aiming for A coalition which was instrumental in co-ordinating international investor support.

Cllr Rose attended an investor meeting with Shell's newly appointed chairman, Chad Holliday. Of note for Shell are the announcements that the company has left ALEC (the American Legislative Exchange Council) with a Shell spokesperson saying 'its stance on climate change is clearly inconsistent with our own' and its decision to cease further exploration activity in offshore Alaska for the foreseeable future

A further meeting was held with BP to follow up on developments precipitated by the Strategic Resilience resolution and to explore any impacts on the company's business development plans.

Painted owls welcomed people to Birmingham on the way to the National Grid AGM

LAPFF Executive Member, Geik Drever, attended the National Grid AGM. Ms Drever addressed Sir Peter Gershon, the chairman of National Grid to ask about the influence of climate change on the company's business strategy and met briefly with the Chief Executive, Steve Holliday, following the meeting to clarify how the Company is decoupling profits from carbon emissions.

Palm Oil

Earlier this year, LAPFF wrote with other investors to the Roundtable on Sustainable Palm Oil (RSPO) on strengthening its standards for sourcing palm oil sustainably and to an accelerated timeline. The RSPO has recognised concerns over the development of differing sustainable sourcing initiatives and that it is working to address these. However, the investor group has emphasised that best practice standards ultimately need to be incorporated into the RSPO's core principles and criteria. LAPFF also attended a meeting of the UNPRI Investor Working Group on Palm Oil to discuss ways forward for the group and effective engagement practices with companies listing palm oil as one of their commodities.

There is now a 'spot tool' that investors can use to help identify sustainable producers of palm oil. This tool includes a mapping function that allows users a detailed view of concession sites, along with certification details under, for example, the RSPO. Currently, 25 of the top publicly listed companies selling palm oil are ranked based on a 48 indicator framework. The ratings for this tool are then assigned by an environmental economist. The tool can be found at: http://www.sustainablepalmoil.org/spott/

MEDIA COVERAGE

Bompas IFRS Opinion
Financial Times, IP&E, Invezz, Out-Law

Local Authority Pension Scheme Reform
Public Finance

Clinical Trials Transparency
Local Government Chronicle

Fossil Fuel Divestment
The Lincolnite, Hackney Citizen, Buxton Advertiser

NETWORKS AND EVENTS

The first of the party fringe meetings was held in Brighton, at the Labour party conference with the theme ‘Has Banker Bashing Gone Too Far?’. Speakers included Cllr Kieran Quinn (Chair, LAPFF), Dominic Lindley (New City Agenda), Mike Kane MP, formerly Treasury Select Committee and Joanne Segars Chief Executive NAPF and it was followed by a lively debate.

Other events and meetings attended during the quarter included:

CWC Conference: Cllr Greening presented on LAPFF engagement on labour rights

Equality & Human Rights Commission: Cllr Barnett participated in a roundtable

Frank Bold/CORE Coalition: explored link between governance and sustainable societies

TUSO: event to discuss implications for workers of zero hour contracts/precarious work

Nikko Research Center: met with Japanese investors on shareholder engagement

Green Investment Bank: update on recent Bank activities

NAPF: Decarbonisation of equity portfolios event

Climate Bonds: launch event for climate bonds initiative held at Norton Rose law firm

CDP: managing natural capital risks for an uncertain future

Hacked Off: discussed phone hacking practices of media conglomerates

CONSULTATIONS

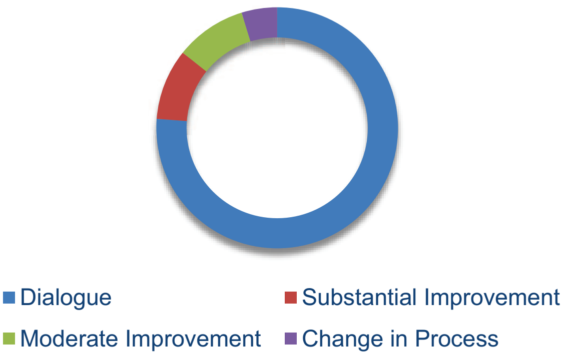
LAPFF submitted a consultation response to the Hong Kong Stock Exchange, which is seeking to revise its environmental, social and governance (ESG) guidance to issuers. Support was voiced for the Exchange’s intention to move toward comply or explain reporting for a number of ESG metrics, in part as an example for other exchanges looking for reporting guidance. However, LAPFF suggested a further move to mandate reporting of carbon emissions. The impetus for this suggestion is the goal of a single global reporting framework, which LAPFF believes is essential for effective action on climate change. LAPFF stated support for international accounting tools - specifically the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard - to promote clarity and comparability in carbon emissions reporting. LAPFF Chairman, Kieran Quinn, emphasised the importance of these efforts in the run up to the Paris climate talks that will take place in December.

COMPANY PROGRESS REPORT

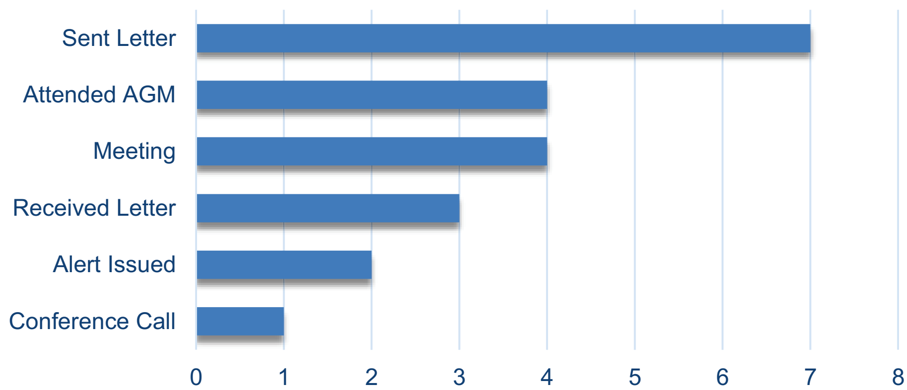
The Forum engaged with **16 companies** during the third quarter.

Company	Topics	Activity/Outcome	Domicile
Trinity Mirror	Governance	Meeting/Substantial Improvement	UK
Astra Agro Lestari	Environmental Risk	Sent Letter/Dialogue	Indonesia
National Grid	Carbon Management	AGM/Moderate Improvement	UK
SSE	Carbon Management	AGM/Dialogue	UK
Vodafone	Governance	AGM/Dialogue	UK
BHP Billiton	Carbon Management	Sent Letter/Dialogue	UK/Australia
John Menzies	Employment Standards	Meeting/Moderate Improvement	UK
Halfords	People and Investment Value	Meeting/Dialogue	UK
Toyota	Carbon Management	Received Letter/Dialogue	Japan
BP	Carbon Management	Meeting/Change in Process	UK
Shell	Carbon Management	Meeting/Dialogue	UK/Netherlands
Volkswagen	Governance	Sent Letter/Dialogue	Germany
Google	Governance	Sent Letter/Dialogue	United States
AGL Australia	Carbon Management	Voting Alert/Dialogue	Australia
BT Group	Audit Practices	AGM/Dialogue	UK
Sports Direct	Employment Standards	Voting Alerts/Dialogue	UK

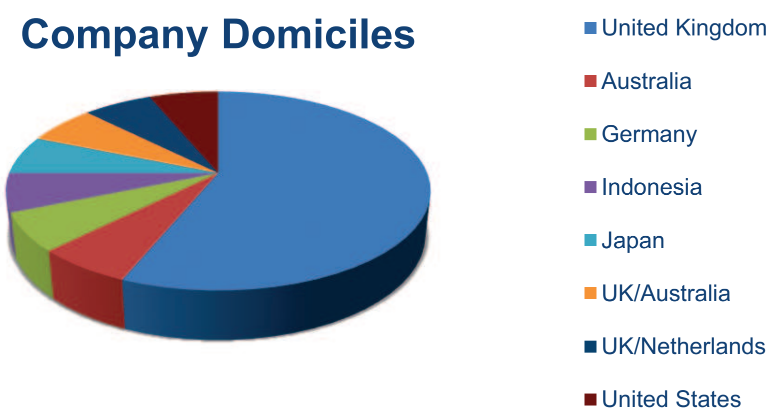
COMPANY ENGAGEMENT OUTCOMES



ENGAGEMENT ACTIVITIES



COMPANY DOMICILES



Local Authority Pension Fund Forum Members

Avon Pension Fund
Barking and Dagenham LB
Bedfordshire Pension Fund
Camden LB
Cardiff and Vale of Glamorgan Pension Fund
Cheshire Pension Fund
City of London Corporation
Clwyd Pension Fund
Croydon LB
Cumbria Pension Scheme
Derbyshire CC
Devon CC
Dorset County Pension Fund
Dyfed Pension Fund
Ealing LB
East Riding of Yorkshire Council
East Sussex Pension Fund
Enfield LB
Falkirk Council
Greater Gwent Fund
Greater Manchester Pension Fund
Greenwich Pension Fund
Gwynedd Pension Fund
Hackney LB
Haringey LB
Harrow LB
Hertfordshire
Hounslow LB
Islington LB
Lancashire County Pension Fund
Lambeth LB
Lewisham LB

Lincolnshire CC
London Pension Fund Authority
Lothian Pension Fund
Merseyside Pension Fund
Newham LB
Norfolk Pension Fund
North East Scotland Pension Fund
North Yorkshire CC Pension Fund
Northamptonshire CC
NILGOSC
Nottinghamshire CC
Powys County Council Pension Fund
Rhondda Cynon Taf
Shropshire Council
Somerset CC
Sheffield City Region Combined Authority
South Yorkshire Pensions Authority
Southwark LB
Staffordshire Pension Fund
Strathclyde Pension Fund
Suffolk County Council Pension Fund
Surrey CC
Teesside Pension Fund
Tower Hamlets LB
Tyne and Wear Pension Fund
Waltham Forest LB
Wandsworth LB
Warwickshire Pension Fund
West Midlands ITA Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund
Wiltshire CC
Worcestershire CC

Report prepared by PIRC Ltd. for LAPFF, www.lapfforum.org.

AVON PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES

This statement sets out the principles that will guide the Avon Pension Fund Committee ("the Committee") when making decisions about the investment of the Fund's assets. It also sets out the framework for investing the Fund's assets and is consistent with the Fund specific funding strategy as set out in the Funding Strategy Statement.

The Local Government Pension Scheme (Management and Investments of Funds) Regulations 2009 ("the regulations") require the Avon Pension Fund ("the Fund") to prepare, publish and maintain a statement of the principles governing its investment of the Fund's monies. As required by the regulations, the Committee will review this statement periodically to ensure it is consistent with the Fund's funding strategy.

This statement is required to cover the following:

- Types of investments to be held
- The balance between different types of investments
- Risk, including the ways in which risks are to be measured and managed
- The expected return on investments
- The realisation of investments
- The extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments
- The exercise of voting rights (if there is any such policy)
- Stock lending
- Statement of compliance with the Myners Principles

1 Investment Objective

The investment objective is to achieve a return on the assets, consistent with an acceptable level of risk that will enable the Fund to meet its pension liabilities over time, that is, to achieve 100% funding in line with the funding strategy. The investment strategy must therefore generate returns that will help stabilise and minimise employer contribution rates in the long term as well as reflect the balance between maximising returns consistent with an appropriate level of risk, protecting asset values and matching liabilities. The investment strategy will reflect the Fund's appetite for risk and its willingness to accept short term volatility within a longer term strategy.

Implementation: The Fund has a strategic benchmark which reflects the Fund's liability profile. The expected return of the current strategy is equivalent to 2.8% p.a. over the expected return on long dated gilts and the expected volatility of the returns relative to liabilities is 10.0% p.a. (source: JLT). This investment objective is consistent with the investment return assumptions in the funding strategy used in the actuarial valuation.

2 Types of Investment Held

The Fund may invest in any type of investment permitted under the regulations. Consideration of each asset class or investment approach will include potential risk adjusted return expectations and an assessment of non-financial risks, liquidity, product structure and management costs.

Implementation: The Fund invests in equities (both UK and overseas), diversified growth funds, index-linked and fixed interest stocks, Fund of Hedge Funds and property funds. The strategic benchmark includes an allocation to infrastructure which has yet to be invested. Some of these investments are in segregated portfolios but the majority are in pooled funds. In addition, the Fund will normally hold a proportion of its monies in short-term bank deposits and money market funds to meet operational requirements.

3 Asset Allocation and Expected Long Term Returns on Investment

The Committee is responsible for setting the strategic asset allocation for the Fund which in turn must be consistent with the investment return assumed in the funding strategy.

The investment strategy reflects the medium to long term nature of the liabilities but must also provide flexibility to manage short term volatility in markets. In addition, the investment strategy must take account of possible changes to cash flows as the membership profile of the Fund or the benefits structure changes.

The investment strategy reflects the differing return and risk profiles of each asset class. However, long term expectations are not consistently generated over all time frames and, for all asset classes, there can be periods of under or out performance compared to the long term expectations.

The strategic framework includes a target allocation against which strategic performance will be monitored. In addition there are ranges for each asset category that allow limited deviation within the framework. The ranges enable the Fund to reflect changes in the market outlook and provide greater flexibility to implement cash management and rebalancing. Over the longer-term it provides a framework within which de-risking strategies could be implemented.

For each portfolio managed on an active basis, the manager has an outperformance target which means that the Fund should outperform its strategic benchmark, everything else being equal. The outperformance target will reflect the level of risk and approach to investing taken by each active manager. The strategic benchmark does not assume any outperformance from the investment managers.

Implementation: The strategic asset allocation along with assumptions for expected return and volatility for each asset class is set out in the table below. This strategy was agreed in 2013 and will be implemented during 2013 and 2014.

Asset Class	% of Fund	Range	Expected return*	Expected Volatility
Growth assets	**80%**	**65 -85%**		
Equities	*50%*	*45 - 55%*		
Developed	*40%*	*35 - 45%*	*+3.75%*	*15 - 20%*
Emerging	*10%*	*5 - 15%*	*+4.25%*	*15 - 25%*
Diversified Growth Funds	*10%*	*5 - 15%*	*+3.75%*	*10 - 15%*
Illiquid Growth	*20%*	*15 - 25%*		
Hedge Funds	*5%*	*0 - 7.5%*	*+1.5%*	*6 - 15%*
Property	*10%*	*5 - 15 %*	*+2.5%*	*5 - 10%*
Infrastructure	*5%*	*0 - 7.5%*	*+2.5%*	*5 - 10%*

Other Growth	*0%*	*0 - 5%*	*+2.5%*	
Stabilising Assets	**20%**	**15 - 35%**		
Government Bonds	*3%*	*0 - 10%*	*0%*	*5 - 10%*
Index linked bonds	*6%*	*3 - 10%*	*-0.25%*	*5 - 10%*
Corporate Bonds	*8%*	*4 - 20%*	*+1.0%*	*5 - 10%*
Other Bonds	*3%*	*0 - 5%*	*+1.0%*	*5 - 10%*
Cash	**0%**	**0 - 5%**		

** Expected return is expressed as an excess return over UK gilt yields or the "premium over gilts" to reflect the extra risk being taken. Gilts are used as the basis for expected returns as they are a proxy for valuing the liabilities.*

The inclusion of diversified growth funds (DGFs), property and hedge funds in the strategy is expected to reduce the overall volatility of returns without significantly altering the Fund's expected long term return. The reduction in volatility results from these assets and investment approaches having a lower correlation to both bond and equity returns over the long term. In addition the Fund expects to benefit from the "illiquidity premium" from investing in property and infrastructure, and to a lesser extent, hedge funds.

The Fund takes a passive approach to hedging its US dollar, Yen and Euro developed market equity exposure. This is managed on a segregated basis. Foreign currency exposure is expected to be an unrewarded risk over the longer term, thus the currency hedging is to protect the sterling value of the hedged portfolios and to reduce the volatility that arises from currency. The passive approach seeks to achieve this reduction in volatility in an efficient and cost effective way. A dynamic rebalancing policy is triggered when the proportions invested in bonds and liquid growth assets (equities and DGFs) deviates by more than permitted. The rebalancing policy will ensure that the allocations remain within the strategic ranges.

Cash is included in the strategic benchmark but in principle the Fund will aim to be fully invested. Cash is held by the managers, at their discretion within their investment guidelines, and internally to meet working requirements. The strategic benchmark allows cash to be held for tactical or operational reasons.

The cash held internally is managed by the Council's Treasury Management Team. This cash is separately accounted for and is invested in line with the Fund's Treasury Management Policy.

The strategic policy and the medium term performance of the managers are monitored at quarterly Panel and Committee meetings.

4 The balance between different types of investment and the Investment Management Structure

The Fund will at all times invest across a diversified portfolio of investments to reduce investment risk. In addition to diversifying by assets, the Fund will invest across a number of managers and via different approaches and styles to investing. Whilst the Fund experiences a deficit in its funding position, there will be a significant allocation to "return generating" assets such as equities and diversified growth funds. The equity portfolio will be diversified by manager, geography and investment style.

The Fund will invest via segregated and pooled portfolios based on the appropriateness for each portfolio (namely, cost, liquidity, impact on voting rights, flexibility and speed of implementation). The Fund will invest across a combination of passive, enhanced indexation, active and absolute return investment approaches based on return potential, cost and flexibility of implementation.

Implementation: A significant proportion of the Fund is invested in passive mandates (across equity and bonds markets only) which rely solely on market returns to generate the investment return. The rest of the Fund is invested in active mandates (across equities, bonds, DGFs, hedge funds, infrastructure and property) where manager skill is expected to enhance the market return and manage risk, to a greater or lesser extent.

Passive approaches aim to deliver the market return by replicating the index in a cost and implementation efficient manner. These are suitable for equity and bond portfolios managed on a pooled or segregated basis. An "enhanced indexation" approach to managing equity portfolios aim to provide an incrementally higher return than the index but at a low risk relative to the index. This approach utilises quantitative models to generate portfolios. Active managers seek to outperform the index or benchmark through the selection of the underlying investments. Such portfolios are usually more concentrated and can be more or less volatile than the index/benchmark depending on the investment approach. Within the Fund, the active equity mandates tend to be more volatile than the index whereas the DGFs target a lower volatility through active management.

Each mandate has a portfolio specific outperformance and risk target. Absolute return portfolios seek to provide a positive return in all market environments. These managers use a wide range of investment techniques to generate returns. A passive currency hedging mandate aims to reduce the volatility arising from currency exposure in an efficient and cost effective manner.

The investment structure is detailed in the table below. As the Fund is transitioning to the strategic benchmark set out in 3 above the allocations per manager will not be consistent with the strategic benchmark allocations and will exceed 100% as new mandates yet to be seeded are included:

Manager	***Mandate***	***Performance Objective***	***% of Fund***	***Inception date***
BlackRock	*Passive multi-asset*	*In line with customised benchmark*	*34%*	*01/04/03*
Jupiter Asset Management	*UK Equities (Socially Responsible Investing active)*	*FTSE All Share +2% p.a.*	*5%*	*01/04/01*
TT International	*UK Equities (unconstrained active)*	*FTSE All Share +3-4% p.a.*	*5%*	*11/07/07*
Invesco Perpetual	*Global ex-UK Equities (Enhanced Indexation)*	*MSCI Global ex-UK Index +0.5% p.a.*	*6.5%*	*19/12/06*
State Street Global Advisors	*Europe ex-UK Equities (Enhanced Indexation)*	*FTSE World Europe ex-UK Index +0.5% p.a.*	*3.5%*	*14/12/06*
State Street Global Advisors	*Pacific inc. Japan Equities (Enhanced Indexation)*	*FTSE Developed Asia Pacific Index +0.5% p.a.*		*14/12/06*
Schroders Investment Management	*Global Equities (unconstrained active)*	*MSCI All World Index +2-4%*	*6%*	*01/04/11*
Genesis Investment	*Emerging Market Equities*	*MSCI Emerging Markets*	*5%*	*13/12/06*

Management	*(unconstrained active)*	*Index*		
Unigestion	*Emerging Market Equities (active)*	*MSCI Emerging Markets Index + 2% p.a.*	*5%*	*21/01/14*
Standard Life	*Diversified Growth Funds (active)*	*LIBOR + 4% p.a.*	*6.7%*	*04/02/15*
Pyrford International	*Diversified Growth Funds (active)*	*RPI + 5% p.a.*	*3.3%*	*14/11/13*
JP Morgan Asset Management	*Fund of Hedge Funds*	*The higher of LIBOR +3% or 6% p.a.*	*5%*	*13/07/15*
Royal London Asset Management (RLAM)	*UK Corporate Bond Fund (active)*	*iBoxx £ non-Gilt Index +0.8% p.a.*	*5%*	*11/07/07*
Schroders Investment Management	*UK Property (active)*	*IPD UK Pooled Property Fund Index +1% p.a.*	*5%*	*01/02/09*
Partners Group	*Overseas Property (active)*	*IPD Global Property Index +2% p.a.*	*5%*	*18/09/09*
Record Currency Management	*Currency hedge (US$, Yen and Euro equity exposure)*	*N / A*	*n/a*	*26/07/11*
Current Structure			**100%**	
New mandates still to be seeded				
IFM	*Infrastructure (active)*	*Gilts +2.5% p.a.*	*5%*	*30/09/14*

The Fund's investment managers are remunerated either by way of an ad valorem fee, i.e. the fee is a percentage of the value of assets under management, or a combination of an ad valorem and performance-related fee. The principle of performance-related fees is that the base fee is lower and that the manager is only paid a higher fee if the performance objective set by the Fund is met or exceeded.

5 Risk

The main risk for the Fund is the mismatch between its assets and liabilities. As a consequence if the investment returns are less than that required in the funding strategy the funding level will deteriorate, all else being equal. The main risks within the funding strategy are interest rate, inflation and mortality risks, and investment risk arising from the investment portfolio, which is partially offset through diversification.

Investment by its very nature is a risk based activity where the returns achieved will reflect differing levels of risk. There are a number of investment risks to consider within an investment fund, namely, market, credit, currency and liquidity risks. Consideration of financially material non-financial risks is discussed in the section "Responsible Investment Policy".

The aim of the investment strategy and management structure is to manage the appropriate level of risk for the return target which reflects the funding strategy. The Fund's investments are managed by external investment managers who are required to invest the assets in line with the investment guidelines set by the Fund, appropriate for each mandate. An independent custodian safe keeps the assets on behalf of the Fund.

Implementation: Investment risk is controlled through the strategic policy which ensures diversification of investments across a range of asset classes and markets that have low correlations with each other and across a selection of managers. As most of the portfolio is exposed to market risk, the main risk to the Fund is a fall in market prices.

Although market movements cannot be completely avoided, and indeed there are periods when all assets become more highly correlated, the impact can be mitigated through diversifying across asset classes and approaches to investing.

Credit (and counterparty) risk arises in the bond portfolios, the currency hedging programme, the management of cash balances and the trade settlement process. At all times the Fund ensures it appoints reputable and creditworthy external suppliers and that credit management policies are adhered to.

The currency hedge manages the unrewarded risk that arises from the foreign currency exposure. Adverse movements in the currency that overseas assets are denominated in will reduce the value of those assets when translated into sterling.

Liquidity risk is the risk that the Fund cannot realise its assets as needed. As a result, the Fund limits its investment in less liquid asset classes such as property, hedge funds and infrastructure.

Risk and return of the overall Fund and the individual portfolios is monitored closely to ensure the managers are investing in line with their expected long term risk return parameters and that the Fund overall is achieving its investment objectives.

The investment strategy provides some protection against the liability risks, mainly interest rates and inflation. The gilt, corporate bond and other bonds (14% of the Fund) provides an interest rate hedge. Infrastructure could also provide some interest rate protection depending on the structure of the mandate. Index Linked bonds provide a direct hedge against inflation and changes to inflation expectations whilst property and infrastructure, and to a lesser extent, equities and DGFs, provide an inflation hedge over the medium to longer term. The Fund is not hedged against mortality risk.

6 Regulatory Investment Limits

The regulations impose certain "prudential" limits on the way in which the Fund's assets can be invested. In principle these are designed to ensure diversification and reduce risk. For example there are limits on the amounts which can be invested in partnerships, unlisted securities, unit trusts and life funds. There is a two tier system of prudential limits. The first tier is the "normal" limit; the second tier is a set of higher limits which can only be utilised once the Committee has passed a resolution, having complied with certain conditions.

Implementation: Currently all the "normal" prudential investment limits apply to the Fund, except for the following:

- *Investments in Life Funds - following a Committee resolution in March 2006, this has been increased to the maximum limit of 35% to accommodate the life fund investments managed by Blackrock.*
- *Investments in single partnerships - following a Committee resolution in December 2008, this has been increased to the maximum limit of 5% to accommodate the property investments managed by Partners.*

7 Realisation of Investments

The Fund must be able to realise its investments within a reasonable period appropriate for its cash flow and maturity profile. Therefore the investment strategy must reflect the need to realise assets or use of investment income to meet projected cash flow requirements.

Implementation: The Fund's investment policy is structured so that the majority of its investments (70% in quoted equities and bonds, 10% in DGFs) which it holds can, except in the most extreme market conditions, be readily realised. However, the growth in indirect investment vehicles enables the Fund to invest in less liquid asset classes and to build well-diversified portfolios. Property and infrastructure are long term investments which the Fund will not be able to realise in a short period. "Lock-up" periods are normal practice in Fund of Hedge Funds (to manage the in/out flows to ensure existing clients' capital is protected) which means that these investments are not readily realised. However, the Fund has sought to minimise the length of these "lock-up" periods when selecting managers and investment vehicles.

The Fund is transitioning to a more mature membership profile as the monthly payment of pensions is no longer met by pension contributions, thus there is a need to realise assets or utilise investment income on an on-going basis within the investment strategy. Based on projected cash flow, investment income from the segregated portfolios will be used to meet any shortfall in cash inflows prior to divesting of assets.

8 Responsible Investing Policy

The Avon Pension Fund recognises that responsible investing (RI) issues can have a material impact on the value of the investments held by the Fund. It also believes it has a responsibility to carry out its stewardship activities effectively. As a result the Committee has a Responsible Investing Policy that sets out the framework for considering such issues throughout the investment decision-making process.

Implementation: The Committee approved its Responsible Investing Policy in June 2012. The full policy can be accessed via www.avon.avonpensionfund.org.uk.

The policy includes:

- *analysis of the impact of RI issues on each asset class as part of strategic reviews*
- *evaluation of an investment manager's approach for assessing RI risks within their investment process in mandate tenders*
- *monitoring of the decisions by its investment managers regarding RI issues that have a material financial impact on the Fund*
- *voting and engagement policy*
- *participation in collaborative groups to influence corporate behaviour*

Although the investment structure means that some parts of the policy are more relevant to some mandates than others, the strategic aspects will apply across the entire Fund. The managers of actively managed portfolios have provided a statement setting out the extent to which they take social, environmental and ethical considerations into account in their investment processes, which are included as Appendices to this Statement.

The Fund has a fiduciary duty to invest Fund monies in order to achieve the best possible financial return consistent with an acceptable level of risk. Operating within this framework, Jupiter manages a UK equity portfolio in accordance with Socially Responsible Investment (SRI) criteria (within this context SRI means investing in companies which contribute to, or benefit from, more environmentally and socially *sustainable economic activity), justified by the argument that superior performance could be achieved over time from a portfolio constructed on this basis. Given the mandate objective, this SRI portfolio has a bias towards mid-sized / smaller companies and this, together with the concentrated nature of the portfolio, means that the volatility of investment returns is high. The portfolio includes companies providing products/services which solve environmental and social problems and those which minimise the environmental and social impacts of their processes. The categories of stock which the portfolio would exclude are for example, tobacco, armaments, nuclear power and animal testing of cosmetics and toiletry products.*

At the strategic level, a manager's approach to identifying and managing SRI risks and opportunities is evaluated as part of the tender process for appointing new managers. It is also incorporated into the on-going process of monitoring the investment managers' performance.

The Fund has adopted the FRC UK Stewardship Code which aims to enhance the quality of engagement between institutional investors and companies. The aim is to improve long-term returns to shareholders and by setting out good practice on engagement with investee companies, improve governance standards. The Fund seeks to adhere to the Stewardship Code, and encourages its appointed asset managers to adopt the Code. As a result, each of the investment managers has an explicit corporate governance policy explaining how and when they will intervene in a company and how they measure the effectiveness of their strategy. In practice the Fund's policy is to apply the Code both through its arrangements with its asset managers, the monitoring of its voting activity by an independent 3rd party and through membership of the Local Authority Pension Fund Forum, a collaborative body seeking to promote best practice in corporate governance.

9 Exercise of Voting Rights

The Fund recognises its responsibility as a shareholder to actively encourage good corporate governance standards in the companies in which it invests as poor governance can negatively impact shareholder value.

Implementation: The Fund requires its managers to vote their UK company shares in line with their internal voting policy. The Fund has appointed an independent proxy voting agent to monitor the voting activity of the managers which will be reported to the Committee at least annually. The Fund will also publish an annual summary of its voting activity and trends (provided by the proxy voting agent).

For overseas markets voting is left to the discretion of the managers but they are encouraged to exercise voting rights where practical.

10 Stock Lending

The Fund allows stock held by the Fund to be lent out to market participants.

Implementation: The Fund permits holdings in its segregated portfolios to be lent out to market participants. The Fund's custodian acts as the Fund's lending agent and the Fund receives income from the lending activities. The Fund retains the right to recall loaned stock or block stock from being loaned from its segregated portfolios should the Fund wish to not lend the stock for any reason.

The stock lending policy on pooled funds is determined by the individual investment managers. Any income not retained by the fund manager and / or the lending agent is incorporated in the net asset values of each pooled fund.

11 Myners Principles

The Myners Principles sets out a code of best practice in pension fund governance, investment decision making and disclosure. Regulations state that local authority pension funds are required to make clear in their Statement of Investment Principles the extent to which they comply with these principles.

Implementation: The Fund fully complies with the principles. Appendix 6 sets out the Fund's compliance.

To Be approved by Avon Pension Fund Committee on 11 December 2015

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Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**11 DECEMBER 2015**
TITLE:	**PENSION FUND BUDGET AND CASHFLOW MONITORING** **(1) EXPENDITURE FOR YEAR TO 31 OCTOBER 2015** **(2) CASHFLOW FORECAST**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	

List of attachments to this report:

Appendix 1 Summary Financial Accounts: Year to 31 October 2015
Appendix 1A Summary Budget Variances: Year to 31 October 2015
Appendix 2 Cash Flow Forecast

1 THE ISSUE

1.1 The purpose of this report is to inform the Committee of administration and management expenditure incurred against budget for the 7 months to 31 October 2015. This information is set out in Appendices1 and 1A**.**

1.2 This report also contains the Cash Flow forecast for the year to 31 March 2016.

2 RECOMMENDATION

That the Committee notes:

2.1 Administration and management expenditure incurred for 7 months to 31 October 2015

2.2 Cash Flow Forecast to 31 March 2016

3 FINANCIAL IMPLICATIONS

3.1 The administrative and management costs incurred by the Avon Pension Fund are recovered from the employing bodies through the employers' contribution rates.

3.2 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 provide that any costs, charges and expenses incurred administering a pension fund may be paid from it.

4 COMMENT ON BUDGET

4.1 The summary Financial Accounts for the 7 months to 31 October 2015 are contained in **Appendix 1.**

The forecast for the year to 31 March 2016 is for expenditure to be £843,000 under budget. Within the directly controlled Administration budget expenditure is forecast to be £50,000 below budget. The forecast reduction in directly controlled expenditure results from the delay in appointing staff to assist in the GMP data reconciliation project and the delay in appointing a Custody & Finance Officer (staff are now in post). There have also been savings on Communication costs. The IT Strategy actual expenditure will accelerate during the second half of the year as projects are put in to action. The full year spend on the strategy is therefore expected to be on budget.

4.2 In that part of the budget that is not directly controlled, expenditure is forecast to be under budget by £793,000. This underspend all relates to Investment manager fees. The reduced spending is due to market returns being below the level assumed in the preparation of the budget. This is offset slightly by higher performance related fees than anticipated when setting the original budget which are payable in 2015/16.

4.3 Explanations of the most significant variances are contained in **Appendix 1A** to this Report.

5 CASH FLOW FORECAST

5.1 The Service Plan includes a cash flow forecast which is monitored within this report. In recent years the Fund has changed from being cash flow positive (accumulating cash from contributions at a greater rate than paying out cash in benefits and expenses) to being cash flow negative (excluding investment income). This is part of the normal life cycle of a pension fund. The change has necessitated a much closer monitoring and forecasting of cash flows. Negative cash flows are managed by using the income from the investment portfolio. Details of the cash flow forecast for the whole Fund are given in **Appendix 2.**

5.2 The 2015-2018 Service Plan included a cash flow forecast showing a net outflow in 2015/16 of just over £24m.

The actual cash flow to 31 October was a net inflow of just under £1m against a budgeted outflow of £14m for the same period. The variance was due to the receipt of a termination deficit payment from an employer exiting the Fund and the payment by some employers of annual deficit recovery contributions for 2015/16 in full in April 2015 instead of in monthly instalments (the effect of these advance payments unwinds during the year and so has no effect overall in the full year).

Pension lump sum payments were lower than expected while investment income received as cash was higher than budgeted. These factors were offset by the bulk transfer payment relating to Probation Service members transferring to the Greater Manchester Fund and higher than expected pension payments.

As a result the current forecast for the full year is for a net outflow of £15.6m against a budgeted outflow of £24.2m. This forecast includes a repayment to Bristol City

Council for the £4.5m contribution overpayments that were previously reported to committee.

6 **EQUALITIES**

6.3 No items in this Report give rise to the need to have an equalities impact assessment.

7 **CONSULTATION**

7.3 None appropriate.

8 **ISSUES TO CONSIDER IN REACHING THE DECISION**

8.3 There are no other issues to consider not mentioned in this Report

9 **ADVICE SOUGHT**

9.3 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director - Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Martin Phillips Finance & Systems Manager (Pensions) Tel: 01225 395259.
Background papers	Various Accounting and Statistical Records
Please contact the report author if you need to access this report in an alternative format	

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APPENDIX 1

AVON PENSION FUND

SUMMARY FINANCIAL ACCOUNT : YEAR ENDING 31 MARCH 2016

	7 MONTHS TO 31 OCTOBER 2015			FULL YEAR 2015/16		
	BUDGET £	ACTUAL £	VARIANCE £	BUDGET £	FORECAST £	VARIANCE £
Administration						
Investment Expenses	39,876	43,139	3,263	68,359	68,359	0
Administration Costs	42,823	32,644	(10,179)	73,411	73,411	0
Communication Costs	39,521	11,396	(28,125)	67,750	47,750	(20,000)
Payroll Communication Costs	24,744	35,713	10,969	42,418	42,418	0
Information Systems	176,391	188,641	12,251	302,384	302,384	0
Salaries	875,749	817,912	(57,837)	1,501,284	1,471,284	(30,000)
Central Allocated Costs	234,547	234,547	0	402,081	402,081	0
Miscellaneous Recoveries/Income	(129,617)	(112,534)	17,083	(222,200)	(222,200)	0
IT Strategy	86,108	31,222	(54,886)	147,614	147,614	0
Total Administration	**1,390,142**	**1,282,682**	**(107,461)**	**2,383,101**	**2,333,101**	**(50,000)**
Governance & Compliance						
Investment Governance & Member Training	172,468	79,224	(93,244)	295,660	295,660	0
Members' Allowances	23,314	5,023	(18,291)	39,966	39,966	0
Independent Members' Costs	11,237	10,308	(929)	19,264	19,264	0
Compliance Costs	246,983	204,003	(42,981)	423,400	423,400	0
Compliance Costs recharged	(145,833)	(67,085)	78,749	(250,000)	(250,000)	0
Pensions Board	21,817	13,456	(8,360)	37,400	37,400	0
Total Governance & Compliance	**329,986**	**244,930**	**(85,056)**	**565,690**	**565,690**	**0**
Investment Fees						
Global Custodian Fees	49,088	47,664	(1,424)	84,150	84,150	0
Investment Manager Fees	10,810,484	3,024,618	(7,785,866)	18,532,259	17,739,334	(793,000)
Total Investment Fees	**10,859,572**	**3,072,282**	**- 7,787,290**	**18,616,409**	**17,823,484**	**(793,000)**
NET TOTAL COSTS	**12,579,700**	**4,599,893**	**(7,979,807)**	**21,565,200**	**20,722,274**	**(843,000)**

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APPENDIX 1A

Summary of main budget variances: Year to 31 October 2015

Variances Analysis of the full year forecast expenditure or income, against budget to the year end.

Expenditure Heading	Variance £*	Most Significant Reasons for Variance
Salaries	(30,000)	Reduced salaries expenditure due to:- - The appointment of additional staff resources to meet the requirements of the GMP reconciliation was delayed but is now proceeding. - The appointment of a Custody & Finance Officer was delayed but has now been completed.
Communication Costs	(20,000)	Savings have been made on guides, leaflets, newsletters and the annual report through greater use of on-line access. There have also been savings on the cost of the employer conference.
Administration	**(50,000)**	
Investment Manager Fees	(793,000)	The fall in markets means there is a reduction in the full year forecast in the fees based on the value of the assets compared to the budget. This has been slightly offset by higher performance related fees payable in 2015/16 than anticipated when the budget was set. There is a small reduction in manager fees following the appointment of the new hedge fund manager. *The expenditure on fees does not include any provision for performance related fees that relate to the period but remain subject to variation as a result of future performance.*
Expenditure Outside Direct Control	**(843,000)**	
Total Forecast Underspend	**(843,000)**	

***() variance represents an under-spend, or recovery of income over budget**
+ve variance represents an over-spend, or recovery of income below budget

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AVON PENSION FUND

Cash Flow Forecast

		SEVEN MONTHS TO 31 OCTOBER 2015			FULL YEAR 2015/16		
		Forecast Per Service Plan	Actual	Variance	Forecast Per Service Plan	Out-turn Forecast	Variance
		£'000	£'000	£'000	£'000	£'000	£'000
Outflows							
Benefits	Pensions	(72,257)	(74,872)	(2,615)	(123,869)	(128,352)	(4,483)
	Lump sums	(19,769)	(15,225)	4,545	(33,890)	(26,099)	7,791
Administration costs		(3,363)	(6,243)	(2,880)	(5,765)	(10,702)	(4,937)
Total Outflows		(95,389)	**(96,339)**	**(950)**	**(163,524)**	**(165,153)**	**(1,629)**
Inflows							
Deficit recovery		4,245	21,353	17,108	7,278	23,248	15,970
Future service Contributions		68,124	69,248	1,124	116,784	114,211	(2,573)
Total Contributions		72,369	**90,601**	**18,232**	**124,062**	**137,459**	**13,397**
Net Cash Flow (excluding Investment Income and Transfers In and Out)		(23,020)	(5,738)	17,282	(39,462)	(27,694)	11,769
Net Transfers In & Out (budgetted as zero)		-	(3,602)	(3,602)	-	(2,600)	(2,600)
Investment income received as cash		8,892	10,151	1,259	15,243	14,626	(617)
Net Cash In-Flow (Out-Flow)		**(14,128)**	**811**	**14,939**	**(24,219)**	**(15,668)**	**8,552**

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Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**25 SEPTEMBER 2015**
TITLE:	**PENSION FUND ADMINISTRATION** **(1) SUMMARY PERFORMANCE REPORT to 30 September 2015** **(2) PERFORMANCE INDICATORS 3 MONTHS TO 30 September 2015** **(3) TPR COMPLIANCE**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	

List of attachments to this report:-

Appendix 1	Employer/APF - scheme leaver performance report to 30 Sept 2015
Appendix 2	Active membership statistics over 12 months to 30 Sept 2015
Appendix 3	Joiners & leavers statistics over 12 months to 30 Sept 2015
Appendix 4	Late payers report – up to 30 Sept 2015
Appendix 5	Balanced Scorecard : KPI's - 3 months to 30 September 2015
Appendix 5A	Annex 1 & 2 Admin case workload status as at 30 Sept 2015
Appendix 6	Customer satisfaction – Feedback in the 3 months to 30 Sept 2015
Appendix 7	IDRP Schedule
Appendix 8	TPR – Data Improvement Plan – to 31 October 2015
Appendix 9	Risk Register

1 THE ISSUE

1.1 The purpose of this report is to inform Committee of Performance Indicators and Customer Satisfaction feedback for 3 months to 30 September 2015 and Summary Performance Reports on Employer and APF performance over 4 years to 30 September 2015 as well as the Risk Register.

1.2 Further to the introduction of The Pension Regulator (TPR) Code of Practise 14 and The Public Service Pensions (Record Keeping & Miscellaneous Amendments) Regulations 2014 this report includes progress on the Data Improvement Plan plus level of employer compliance.

2 RECOMMENDATION

That the Committee notes:

2.1 Summary Performance Report to 30 September 2015.
2.2 Performance Indicators & Customer Satisfaction feedback for 3 months to 30 Sept 2015.
2.3 Progress on the Data Improvement Plan
2.4 Risk Register

3. Employer Performance

3.1 As part of the Pensions Administration Strategy which came into effect in April 2011 a **Performance Report** is sent monthly to each of the four unitary authorities to report on their own and APF's administration performance against agreed targets set in the SLA.

3.2 A summary report to the Committee is a requirement of the Pensions Administration Strategy. The Report for the period to 30 September 2015 is included as **Appendix 1. (Annex 1,2 &3)**

3.3 The Report discloses any poor performing employers which need to improve. It is important that the Committee are made aware of these going forward and the steps taken to assist these employers in improving their performance to avoid the imposition of additional charges

3.4 Bar charts for APF and each of the four Unitary Authorities and collectively 'Other' employers reporting an event during the period. Performance against retirements and early leavers is measured against agreed SLA targets. **Annex 1** shows achievement within target over the current quartile. **Annexes 2 and 3** are comparator reports over the previous 4 year period. It should be noted that for the current year reports for are currently reflecting targets set under the previous SLA (April 2011) and do not take into consideration the increased allowance incorporated in the revised SLA (June 2015) reflecting the complexities of the new CARE scheme arrangements. Revised reports will be available at the next committee.

3.5 Implementation of the Task Project will result in quality and completeness checks of leaver forms on day of receipt. This will enable better recording of data on employer performance, enabling more targeted support & training for employers to submit complete & accurate data first time. The project will be implemented on 1st January 2016. The first report to Committee will be in June 2016.

4. Trends in Membership/Joiners & Leavers

4.1 Active Membership figures in graph format are included as a standard item for Committee meetings to monitor the trend in member movements at this volatile time when higher than normal level of 1) redundancies and 2) potential opt-outs by members concerned about scheme changes.

4.2 The active membership statistics are shown in graph format in **Appendix 2** and the numbers of joiners and leavers feeding into this also in graph format in **Appendix 3.** The increase in membership over the twelve months to 30th September reflects an increase in in the number of part-time workers and workers with multiple employment posts. A more detailed breakdown of active membership type will be included in future committee reports.

4.3 The Committee will be kept informed of the on-going changes and the effect it is having on Scheme membership. In the event that the funding position of the Scheme is significantly affected this will also be reported.

5. Late Payers Report

5.1 The Fund is required to monitor the receipt of contributions and report materially significant late payments to the Pensions Regulator.

5.2 The Fund maintains a record of all late payments, showing the days late, the amount of payment and reason for delay and whether the amount is of significance.

Appendix 4 reports late payers in the 3 month period to 30th September 2015. There were no materially significant late payments in the current reporting period.

6. Year End Data Receipt & Provision of Annual Benefit Statements

6.1 The Year End (YE) process requires all employers within the scheme to submit member data for the Fund year ending 31 March. Timely and accurate completion of the YE process is a regulatory requirement. The data is used to:

- to provide members them with their Annual Benefit Statement by 31 August
- to notify members if they exceed the HMRC Annual Allowance by 5 October
- for the build-up of members' pension accounts
- by the Actuary to calculate your future employer contribution rates

6.2 For 2015 employers needed to supply more information than previously due to the introduction of the CARE scheme in 2014.

6.3 The Fund provided employer support throughout the process, holding four employer training sessions during Jan/Feb 2015 and factsheets and Q&A information were posted on the employers' website.

6.4 As a result of the YE process:

- 70,000 + Annual Benefit Statements (ABS) sent out for active and deferred members)
- 99.7% of ABS went out by 31 August deadline
- Only 105 members did not receive a statement (due to no YE information being received from 9 employers)
- However, 117 employers missed YE deadlines

6.5 Penalties will be charged to employers for failure to meet advertised criteria for the correct and timely supply of data and these are outlined below. The Fund is currently in the process of contacting the CEO/FD's of those employers who failed to meet the agreed deadline and the reason for the penalty charge.

Criteria	Penalty charge	No of employers failed	£ total per criteria
Late or no return of data	£250	60	£15,000
Incorrect data format	£250	32	£8,000
Data with more than 10% errors	£250	74	£18,500
Chased on more than 3 occasions for data	£250	3	£750
Failed on more than one criteria		46	**£42,500 total**

7. Avon Pension Fund – Administration Performance

Balanced Scorecard detailing Key Performance Indicators for the 3 Months to 30th September 2015

7.1 The information provided in this report is based on the Avon Pension Fund's Service Level Agreement which falls in line with the industry standards set out by the LGPC & used in CIPFA benchmarking. All standards fall within the regulatory standards set out in The Occupational & Personal Pension Schemes (Disclosure of Information) Regulations 2015 which require provision of information to members.

7.2 Full details of *performance against target,* in tabular and graph format, are shown in **Appendix 5.** All reports are being reviewed as part of the Task Workflow Project and it is expected that new and updated versions will be available for approval by the Committee in March 2016.

8. Admin Case Workload

8.1 The level of work outstanding from tasks set up in the period (Item C4 and graphs 4-6 of **Appendix 5**) in the 3 month period is reported in **Appendix 5A** by showing what *percentage* of the work is outstanding. As a snapshot, at 30 September 2015 there were 3428 cases outstanding of which 31% represents actual workable cases and 69% represents cases that are part complete, pending a third party response. All reports are being reviewed as part of the Task Workflow Project and it is expected that new and updated versions will be available for approval by the Committee in June 2016.

9. CUSTOMER SATISFACTION FEEDBACK IN 3 MONTHS TO 30 September 2015 - Retirements

9.1 **Appendix 6** reports on the customer satisfaction based on 135 questionnaires returned from members retiring from both active and deferred status (out of a total of 326 questionnaires issued in respect of the reporting period). 95% of deferred members rated the service as good or excellent, with 77% of actives rating the service as good or excellent.

10. IDRP Report

10.1 Under the LGPS Regulations there is the provision that Scheme Members can exercise a right of appeal for any disagreement that cannot be resolved.

This is done under an IDRP. Due to a personnel change and with the introduction of TPR guidelines within its code of practice, a review of the administration procedure is included separately under Agenda Item 15. The table in **Appendix 7** shows the cases going through at the present time.

11. The Pensions Regulator - Data Improvement Plan

11.1 Initial testing as at 1 August 2015 of core data, against TPR's requirement of 100% completeness of data, identified 8887 queries, equating to 99.13% completeness of data. The first update to the data improvement plan reports 932 queries resolved with 886 new queries identified. A summary of the improvement plan is shown below with a comprehensive breakdown attached in **Appendix 8.**

Data type	Cases brought forward	New cases in period	Completed in period	Outstanding	Completeness of date as % of membership
Actives	3278	875	805	3348	99.39%
Deferreds	5143	1	62	5082	98.71%
Pensioners	359	10	30	339	99.80%
Dependants	107	0	35	72	99.73%
Total	**8887**	**886**	**932**	**8841**	**99.41%**

11.2 Data improvement reports will be updated on a monthly basis and reported to Committee quarterly. Reports will be developed to demonstrate work undertaken on the correction of historic cases already identified and new cases identified during each reporting period.

12 RISK REGISTER

12.1 The Risk Register follows the Council's format for each service. It identifies the significant risks that could have a material impact on the Fund in terms of value, reputation, compliance or provision of service and sets out the action taken to manage the risk. Risks identified cannot be eliminated but can be treated via monitoring.

12.2 The risks identified fall into the following general categories:

(i) Fund administration & control of operational processes and strategic governance processes and TPR compliance – mitigated by having appropriate policies and procedures in place, use of electronic means to receive and send data and information

(ii) Service delivery partners not delivering in line with their contracts or SLAs – mitigated by monitoring and measuring performance

(iii) Financial loss due to payments in error, loss of assets due to investment strategy and/or managers failing to deliver required return, fraud or negligence of investment managers or custodian – mitigated by processes to reconcile payments, regular review of strategic return and manager performance and annual review of investment strategy, robust legal contracts to protect against fraud & negligence

(iv) Changes to the scheme – mitigated by project plans with defined milestones and responsibilities, progress reviewed periodically by management team

(v) Increasing political pressure to reform scheme structure and governance frameworks and direct investment decisions – mitigated by having well defined investment policies and by engaging with the government through the consultation process

12.3 The Fund continues to invest significantly in systems and resources to ensure the risks are managed effectively and resilience is built into the service. The arrangements in place are supported by external and internal audit reviews.

12.4 The Fund reviews all risks annually and the top 10 risks and changes quarterly. The Register has been updated this quarter to reflect risk to the investment strategy from the implementation of MIFID II; a low risk given the potential to elect up to professional client status. Pooling of investments has previously been identified as a risk in the register.

12.5 The top 10 risks, including their likelihood, financial impact and mitigating actions are set out in **Appendix 9.**

13 RISK MANAGEMENT

13.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. In addition, it monitors the benefits administration, the risk register and compliance with relevant investment, finance and administration regulations.

14 EQUALITIES

14.1 No items in this Report give rise to the need to have an equalities impact assessment.

15 CONSULTATION

15.1 None appropriate.

16 ISSUES TO CONSIDER IN REACHING THE DECISION

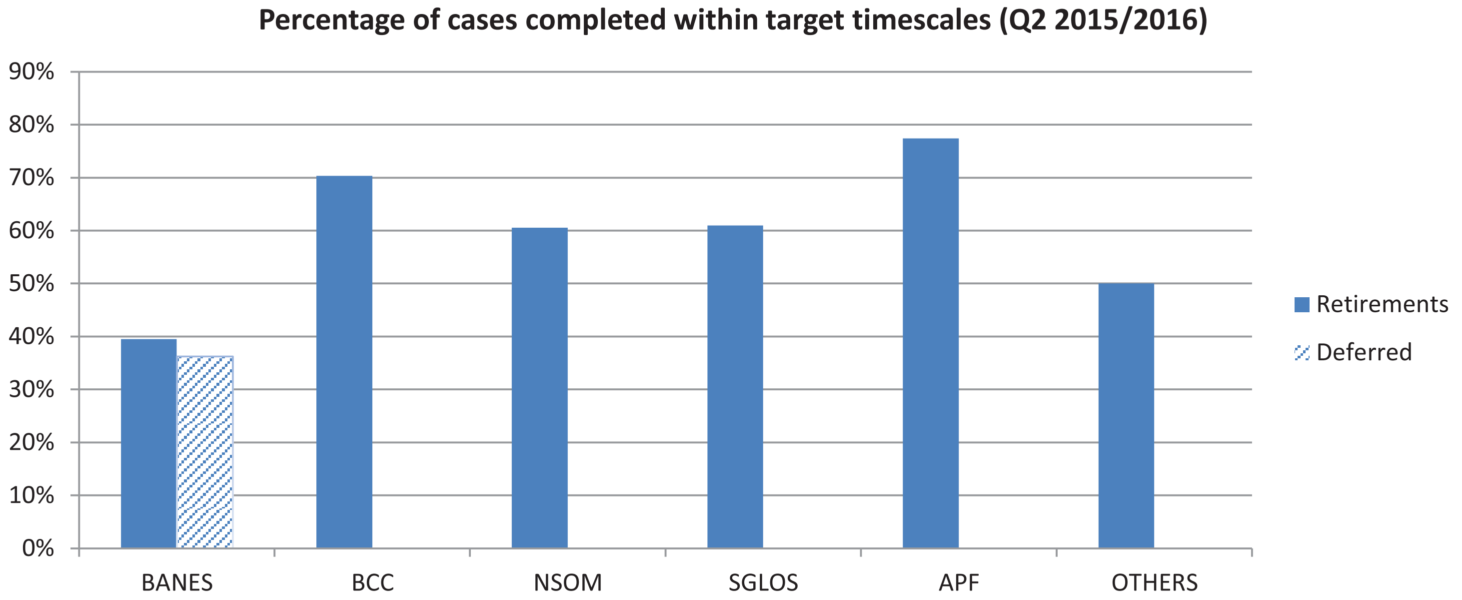
16.1 There are no other issues to consider not mentioned in this Report.

17 ADVICE SOUGHT

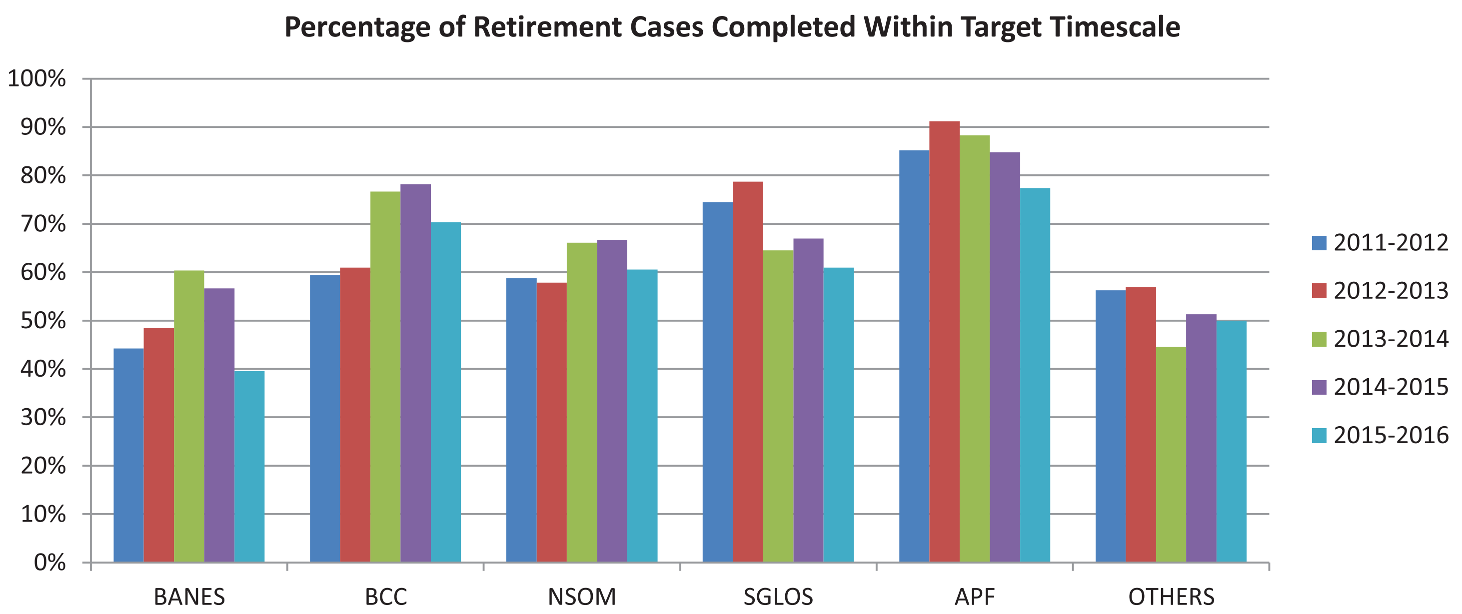
17.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director - Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Geoff Cleak, Acting Pensions Manager Tel: 01225 395277
Background papers	Various Statistical Records
Please contact the report author if you need to access this report in an alternative format	

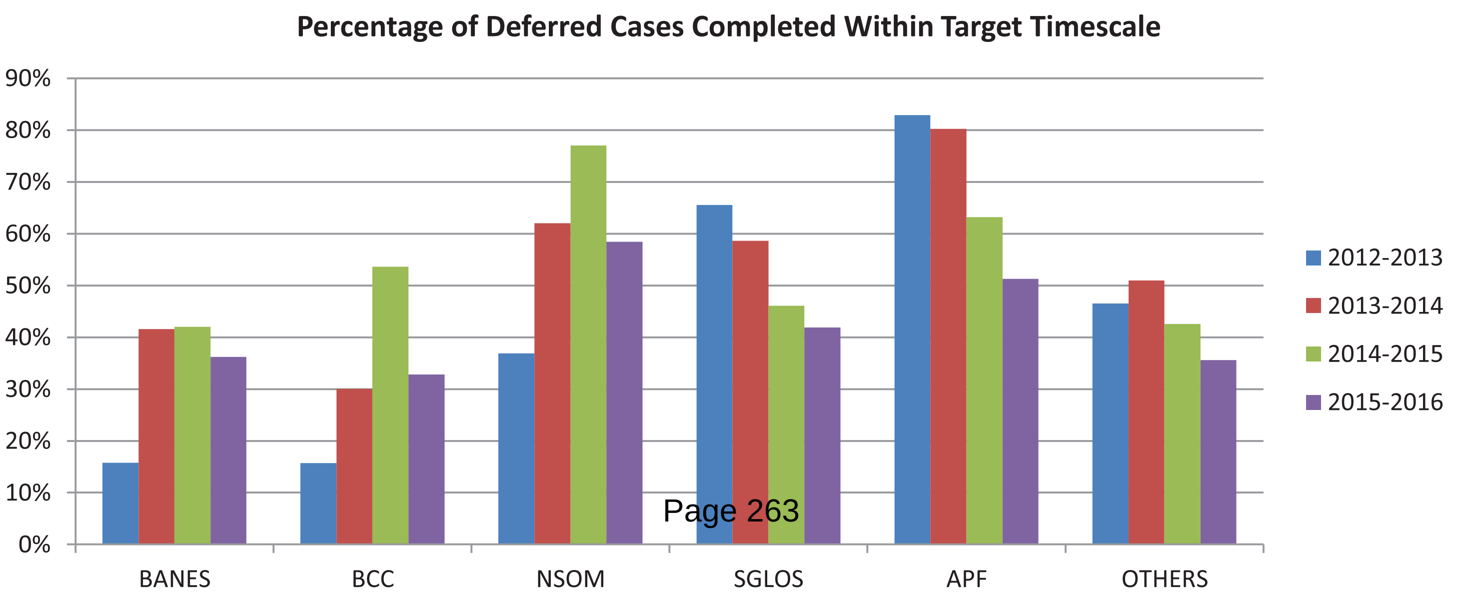
Admin Report: Appendix 1
(Annex 1)



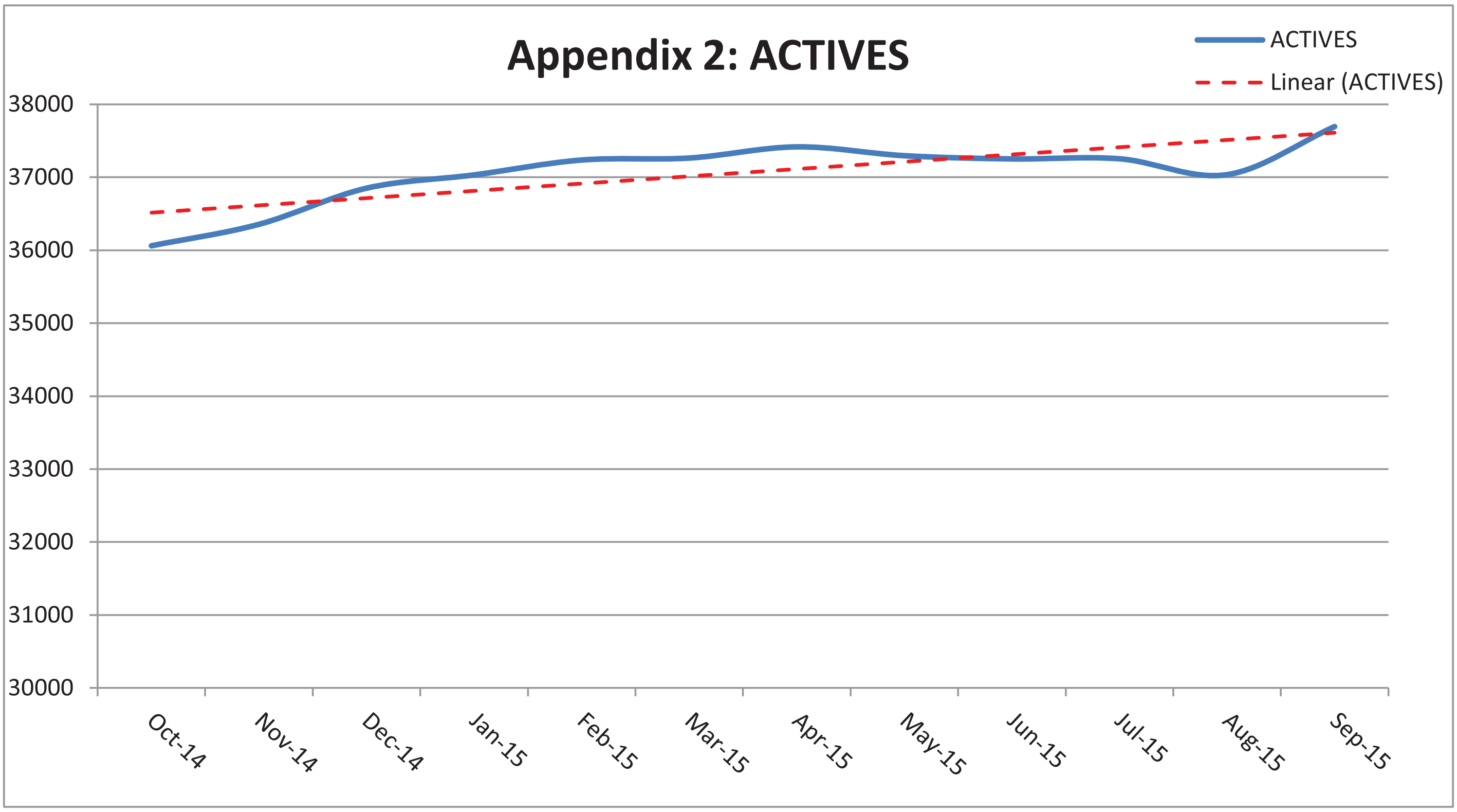
(Annex 2)

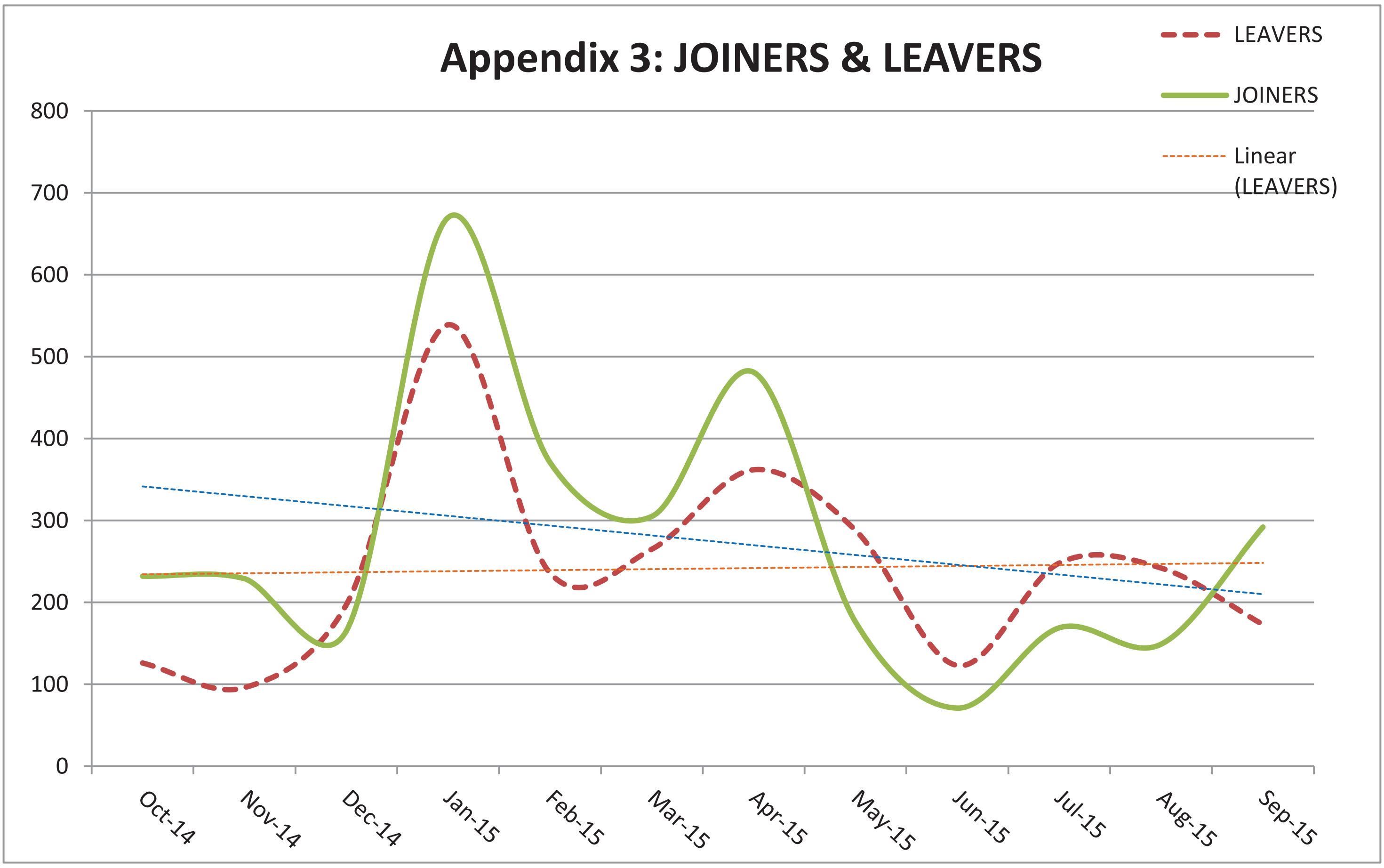


(Annex 3)



Admin Report - Appendices 2 and 3:- Actives, Joiners and Leavers to 30th September 2015





APPENDIX 4

Late Payers Report

Employer	Payroll Month	Days late	Cumulative occasions in year	Amount	Significance	Reason / Action
Patchway Parish Council	July	**25**	2	3,194.49	Significant days late.	No authoriser available to sign cheque. PC have put in arrangement to avoid late payment in future.
Clifton Suspension Bridge	September	**2**	2	4,337.95	Value / days late not material.	Employer has been reminded of obligation to pay in time and asked to take measures to avoid late payment in future.
	Total Days	**27**		**7,532.44**		
			Total Contributions in Quarter	**£38,346,000**	**Late Payments as Percentage of total**	**0.01%**

All late payers are contacted and reminded of their obligations regarding the timing of payments. Where appropriate they are advised on alternative, more efficient methods of payment. Where material, interest will be charged on late payments at base rate plus 1% in accordance with the regulations.

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PENSIONS SECTION ADMINISTRATION

Key Performance Indicators

APPENDIX 5 to Pension Fund Administration Report at 30 Sept 2015

	INDICATOR	Red Amber Green	2014/15 Actual	Target for 2015/16	Actual 3 months to 30/09/2015	Comments
A	**Customer Perspective**					
1	General Satisfaction with Service - retirees' feedback	G	97%	97%	86%	135 out of 326 responses recived from retirees in period - **see Appendix 6**
2a	Service Standards - Processing tasks within internal targets (SLA)			0%		
	Deaths [12 days]	G	91%	92%	83%	19 of 23 Tasks were completed within target
	Retirements [15 days]	G	89%	90%	81%	358 of 442 Tasks were completed within target
	Leavers (Deferreds) [20 days]	A	81%	75%	52%	345 of 664 Tasks were completed within target
	Refunds [5 days]	G	82%	80%	80%	210 of 263 Tasks were completed within target
	Transfers In [20 days]	G	74%	75%	75%	72 of 96 Tasks were completed within target
	Transfers Out [15 days]	A	77%	75%	70%	77 of 110 Tasks were completed within target
	Estimates [10 days]	G	95%	90%	89%	701 of 788 Tasks were completed within target
2b	Service Standards Processing tasks within statutory limits	G	100%	100%	100%	
3	Number of complaints	G			Nil	No complaints received in the period
4	Pensions paid on time	G		100%	100%	All paid on time
5	Statutory Returns sent in on time (SF3/CIPFA)	G				CIPFA Benchmarking data submitted July 2015 - report next meeting
6	Number of hits per period on APF website	G	55898/4658pcm		17,348	5782 per calendar month for reporting period
7	Advising members of Reg Changes within 3 months of implementation				n/a	none this quarter
8	Issue of Newsletter (Active & Pensioners)			0	Yes	none this quarter
9	Annual Benefit Statements distributed by 31 August	G				Total 99.7% Benefit Statements issued by 31.08.2015 statutory deadline
B	**People Perspective**					
1	% of new staff leaving within 3 months of joining				0%	
2	% Sickness Absence a) Short Term	G	1.3%	3%	1%	Ahead of APF target and well ahead of corporate target of 5%
	% Sickness Absence b) Long Term	G	0%	2%	0%	
C	**Process Perspective**					
1	Services actually delivered electronically	G			11.5%	11.5% represents eligible users who have signed up to My Pension Online. 9,452 members now have electronic access.
2	a) Active membership covered by employer ESS	G	72%	90%	75%	
	b) % of employers submitting data electronically	G	58%	70%	60%	
3	% Telephone calls answered within 20 seconds	G	97%	95%	98.7%	9160 calls, 9044 answered within 20 seconds
4	Maintain work outstanding at below 75%	G	30053 created 27944 cleared	75%	76%	9837 created, 7487 cleared - **see Annex 1 Garaph 1 & 2**
5	Year End data receipt	G		100%		2015/16 due by 30 April 2016
6	No. of errors (due to incomplete member data from employers)	G		3%	2%	Acceptable error level
D	**Resource Perspective**					
1	% Supplier Invoices paid within 30 day or mutually agreed terms	G	89%	90%	91%	Business Financial Services (inc Pensions).
2	Temp Staff levels (% of workforce)	G	0.74%		0.0%	Within target

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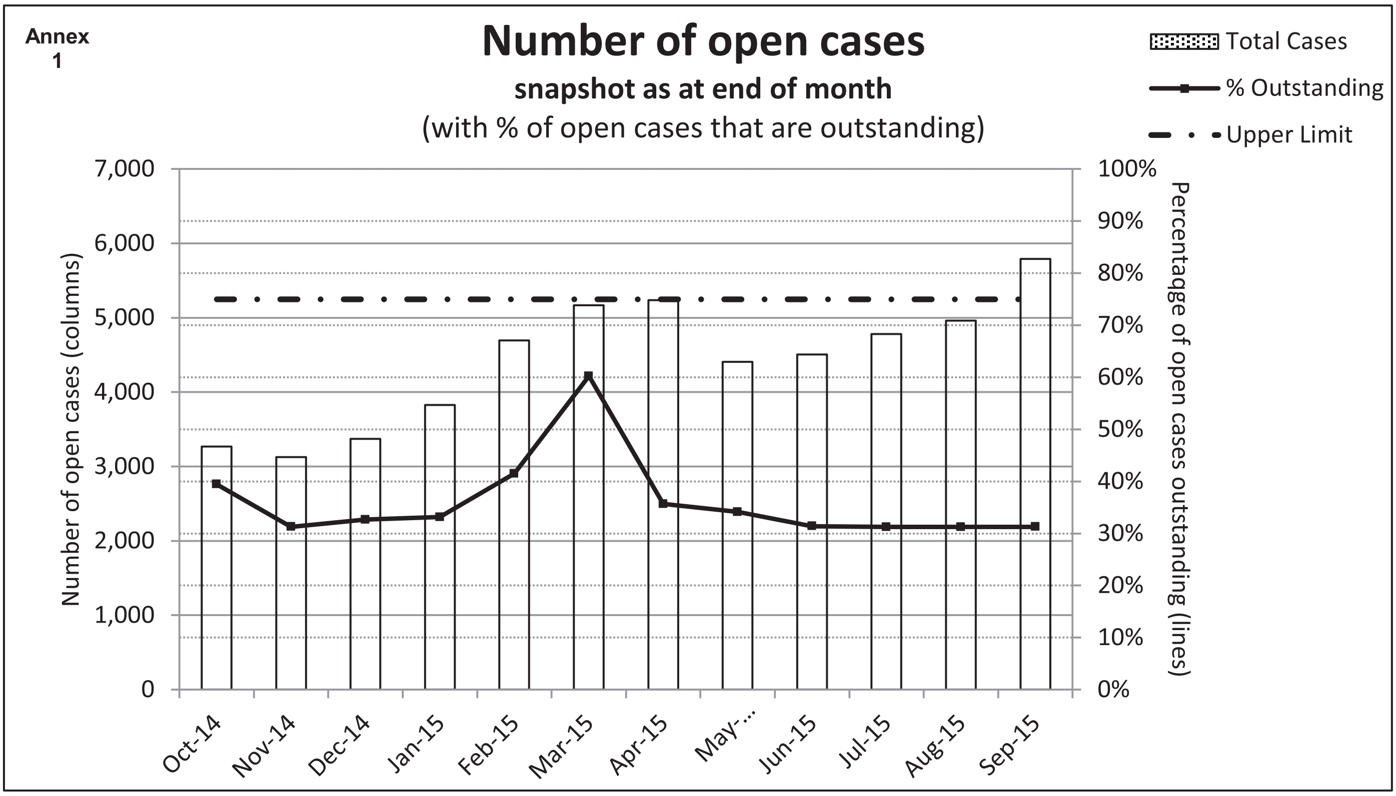
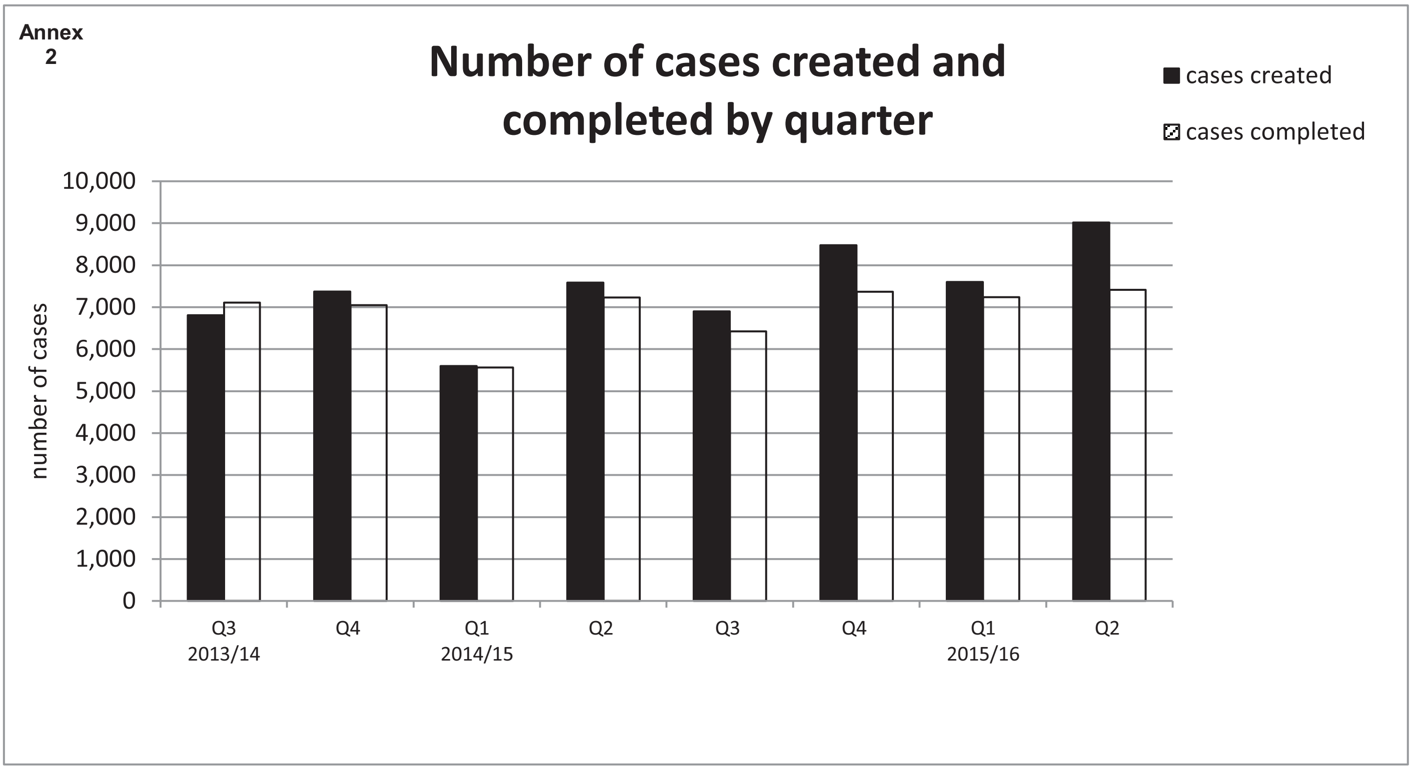
Pension Fund Administration report: Appendix 5A
Case Workload





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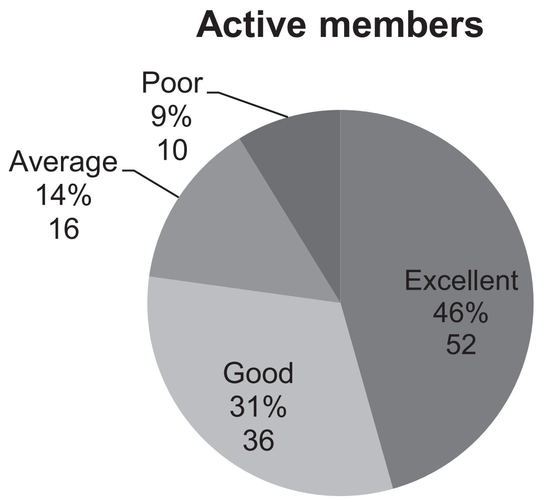
Appendix 6

Customer satisfaction (Jul - Sep 2015)

Responses to the question **"Overall, how would you rate the service you received from Avon Pension Fund?"**

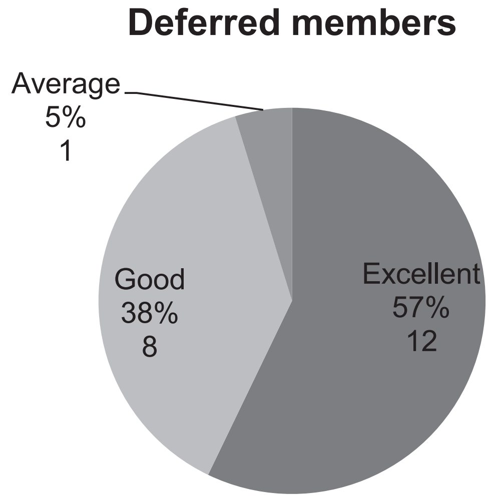
Active members

Number retiring	210
Questionnaires received	114
Response rate	54%



Deferred members

Number retiring	116
Questionnaires received	21
Response rate	18%



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IDRP

From April 2015

AVON PENSION FUND STAGES 1 and 2

STAGE 1						Stage 2		
	Reason	Stage 1 Form received	Date For Review Completion	Review Completed	Decision	Received Monitoring Officer	Date For Review Completion	Review Completed
	Value of Benefits	17/08/2015	16/10/2015	08/10/2015	Not Upheld	26/10/2015	25/12/2015	

Employer Stage 1 - Avon PF Stage 2

STAGE 2	Reason	Employer for Stage 1	Stage 2 Form received	Date For Review Completion	Review Completed	Decision
	Ill Health	Merlin	07/07/2015	05/09/2015	04/09/2015	referred back
	Calculation of Pay [APP]	Bristol	24/08/2015	23/10/2015	21/09/2015	not upheld

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Appendix 8

TPR Improvement Plan Data as at 31 October 2015

Data type	Cases brought forward	New cases in period	Completed in period	Outstanding	Completeness of date as % of membership
ACTIVES Total =36848					
Addresses	664	8	298	374	99.99%
Forename	8	1	6	3	99.99%
Surname	0	0	0	0	100.00%
Date of birth	4	0	2	2	99.99%
NI number	8	0	4	4	99.99%
Title	9	4	13	0	100.00%
Sex mismatch	19	14	31	2	99.99%
Format of hours	31	17	31	17	99.99%
Date joined Fund missing	0	0	0	0	100.00%
Payroll ref missing	109	1	34	76	99.99%
Leaver forms missing	304	830	66	1068	97.10%
Leaver forms in error	Reporting to start 1/2016				
Casual hours missing	1633	0	0	1633	95.57%
Starters in error	Reporting to start 1/2016				
Starters missing	489	0	320	169	99.54%
Total	**3278**	**875**	**805**	**3348**	**99.39%**
DEFERREDS Total =39286					
Addresses	4154	0	27	4127	89.49%
Forename	10	1	2	9	99.99%
Surname	0	0	0	0	100.00%
Date of birth	4	0	1	3	99.99%
NI number	56	0	0	56	99.99%
Title	1	0	1	0	100.00%
Sex mismatch	0	0	0	0	100.00%
Format of hours	0	0	0	0	100.00%
Date joined Fund missing	6	0	3	3	99.99%
Historic refunds	912	0	28	884	97.75%
Total	**5143**	**1**	**62**	**5082**	**98.71%**

PENSIONERS Total =24082					
Addresses	344	4	20	328	98.64%
Forename	13	6	9	10	99.96%
Surname	0	0	0	0	100.00%
Date of birth	0	0	0	0	100.00%
NI number	1	0	1	0	100.00%
Title	0	0	0	0	100.00%
Sex mismatch	1	0	0	1	99.99%
Total	**359**	**10**	**30**	**339**	**99.80%**
DEPENDANTS Total = 3748					
Addresess	59	0	16	43	98.85%
Forename	9	0	8	1	99.99%
Surname	0	0	0	0	100.00%
Date of birth	0	0	0	0	100.00%
NI number	37	0	9	28	99.25%
Title	0	0	0	0	100.00%
Sex mismatch	2	0	2	0	100.00%
Total	**107**	**0**	**35**	**72**	**99.73%**

AVON PENSION FUND RISK REGISTER – TOP 10 RISKS **APPENDIX 9**

				Likelihood					Impact					Risk	RAG	Scale of	Funded by
				1	**2**	**3**	**4**	**5**	**1**	**2**	**3**	**4**	**5**	**score**		**financial**	
	Risk #	**Risk**	**Management actions**	**L**		**M**	**H**		**L**		**M**	**H**				**impact**	
1	R42	Increasing political pressure to reform scheme structure and governance frameworks and to direct investment decisions. Specifically government asked LGPS funds to pool their investment assets. If fund does not have robust plan for change, government may legislate to enforce change: This could result in the committee not making decisions in the best interest of the Fund or being unable to make decisions.	Have well defined investment policies in place setting out investment objectives and criteria. Engaging with the government through the consultation process, with consistent message. Exploring options for pooling assets with other likeminded funds.				4					4		16	R	Greater than £1m	Fund will have to meet costs of setting up any pooling structure
2	R25	Lack of continuity and knowledge within Avon Pension Fund Committee. (This risk arises mainly because some members face re-election simultaneously). Until the new members are fully trained, there may be a delay in decision-making.	Wide representation on Committee including two Independent Members not subject to electoral cycle. Training made available to new members Hold workshops for committee to explore aspects of the fund in more detail to facilitate decision making. Periodically assess training needs and have training plan in place that is reported to committee quarterly.				4				3			12	A	Greater than £1m	Annual budget
3	R26	The Fund fails to achieve investment returns sufficient to meet its liabilities. This could negatively affect the contributions paid by the employing bodies.	Periodic reviews of investment strategy against the funding position and strategy. Annual and quarterly monitoring of strategic allocation, investment returns and tactical opportunities. Strategic issues or tactical opportunities are considered at quarterly meetings of Panel and /or Committee. Ensure specialist advice is taken prior to any investment decisions are made to ensure decisions are in line with Statement of Investment Principles and contribute to			3						4		12	A	Greater than £1m	Increases in employer contribution

			investment objective.														
4	R45	Pension legislation allows people to withdraw their pension "pot" from age 55. This will apply to the LGPS. Although tax penalties may reduce the attractiveness of this option, there is a risk that it matures the fund more quickly than assumed in the 2013 valuation. Cash flow could become more negative due to transfers out.	Work with actuary to understand potential consequences on maturity profile of fund, funding of liabilities and understand the basis for valuing the transferring pension "pots". Incorporate into 2016 valuation. Initial report prepared by actuary in June 2015. Ongoing review as experience develops.			3					3			9	A	Greater than £1m	Potentially through employer contribution, investment income and divestment of assets
5	R51	Risk of Fund retaining incorrect pension liability - GMP Reconciliation Exercise. Following the abolishment of contracting out earnings effective from April 2016, requirement to undertake a reconciliation of GMP liability between Fund and HMRC. Completion date due end 2018	Manage resource requirements over timeframe. Develop project plan to manage data reconciliation process and outcomes including volume metrics. Monitor and report progress and actions taken. Communicate with HMRC and members regarding actions undertaken (ongoing).			3					3			9	A	£100,001 to £1m	Annual budget
6	R05	Non-compliance with Data Protection Act and The Pension Regulators codes of practices and standards. This could lead to fines being imposed, criminal/civil prosecutions, data processing suspended or adverse publicity.	The Pensions Manager is responsible officer for DPA. Confidentiality agreements are in place with the Fund's agents. Ongoing monitoring of the Fund's compliance with the Council's DP policies. All personal data is transmitted from the Fund through secure portals. Members including pensioner members are informed regularly (via payslips & newsletters) that data is provided to third parties for the detection / prevention of fraud viz. National Fraud Initiative. On-going training of employers in their TPR obligations		2						3			6	G	£100,001 to £1m	Annual budget

7	R10	Contributions from Employing bodies to the Fund are incorrect in value or late. This could adversely affect short term cash flow, could mean under/over funding of liabilities, and breach of obligations could lead to TPR fines.	Monthly contributions received are reconciled to employer return (and authorisation is verified). Annual reconciliation of contributions received to member records. Late payers followed up and included in quarterly monitoring report to Committee.		2						3			6	G	£100,001 to £1m	Fines and penalties recharged to employer
8	R19	Lack of adequate resources/ knowledge at scheme employers leading to a failure to comply with obligations to pension fund and employee members, and TPR code	Ensure all information is provided to employers in an accessible and timely manner. Training tailored for employers' staff is provided for all new employers and refresher sessions for existing employers. Enforce penalties allowed under Administration Strategy for repetitive non-compliance with obligations / disproportionate work. Employer training obligations are set out in the Administration Strategy. TPR improvement plan highlights areas of employer failure.		2						3			6	G	£10,000 to £100,000	Annual budget
	R23	Insolvency of Participating Employers in the Fund without sufficient monetary guarantees or bonds to make good their outstanding liability. Any liability will be absorbed by the Fund and spread across other employers, increasing overall liabilities and employer contribution rates.	Covenant assessment monitoring process in place for on-going assessment of financial standing of all employers in the Fund, including review of all employers to identify whether guarantee arrangements are adequate and explore options for obtaining guarantee, bond or contingent assets if appropriate Fund policy is to only admit Transferee and Community Admission bodies where the pension liabilities are guaranteed by a scheme employer. Exit and termination policies in place to ensure financial risk to the Fund is minimised when scheme employers cease to be active employers.			3				2				6	G	Greater than £1m	Increases in employer contribution

10	R27	The investment managers appointed by the Fund to manage the assets fail to achieve their benchmarks. This could cause the Fund to underperform its strategic benchmark and thus fail to achieve the investment returns required to fund the liabilities. This could negatively affect the contribution rates paid by the employing bodies.	Monitoring & managing the performance of the managers is delegated to the Panel. The RAG performance monitoring framework is in place to identify managers that are underperforming and issues that could impact future performance. Issues and changes in RAG ratings are reported to the Panel who agree an action plan to address the issue. The Panel reports quarterly to committee on the performance of the managers and changes in RAG ratings. The impact of underperformance by any individual manager is limited given diversification within investment management structure.			3				2				6	G	Greater than £1m	Increases in employer contribution

Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND COMMITTEE**	
MEETING DATE:	**11 December 2015**	**AGENDA ITEM NUMBER**
TITLE:	**Internal Disputes Resolution Procedure [IDRP]**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Annex 1 Avon Pension Fund: Internal Disputes Resolution Procedure Annex 2 IDRP Timeline		

1 THE ISSUE

1.1 The purpose of this item is to report to Committee the proposed procedure for dealing with disagreements under the Local Government Pension Scheme [LGPS].

1.2 This revised procedure reflects the new LGPS regulations and takes into account guidance received from the Pensions Regulator as set out in its Code of Practice 14.

1.3 The procedure affects both the Avon Pension Fund as the administering authority and all scheme employers.

2 RECOMMENDATION

That the Committee:

2.1 Approves the Internal Disputes Resolution Procedure as outlined in this report

3 FINANCIAL IMPLICATIONS

3.1 The administrative and management costs incurred by Avon Pension Fund are recovered from the employing bodies through the employer's contribution rates

3.2 There are no specific financial implications.

4 Internal Dispute Resolution Procedure

Disagreements under the Regulations

4.1 Whenever a decision is made or in some cases not made, there are provisions for any disagreements that arise to be dealt with under Regulations 74 – 80 of the LGPS Regulations 2013.

4.2 The Pension Regulator has set out in its Code of Practice 14 the requirements of the legislation to have an Internal Dispute Resolution Procedures [IDRP] to be followed.

4.3 Annex 1 incorporates the requirements of both the regulations and Code of Practice to set out how cases of disagreement are to be processed within the Avon Pension Fund.

4.4 Annex 2 sets out a timeline of the process and gives details of who within the administering authority will be responsible for decisions made at different stages of the process.

4.5 Employers have responsibilities within the IDRP and once the procedures are approved will need to be instructed on their role and how the relationship between decisions made and potential disagreements works and how disputes are to be managed.

4.6 A similar exercise will be required for Pension Administration staff.

4.7 The procedures will be reviewed on a regular basis as they are subject to changes in legislation. However a review will be carried out after one year to monitor how the IDRP is working in practice and guidance will be sought from the Pension Board.

5 RISK MANAGEMENT

5.1 No specific issues to consider

6 EQUALITIES

6.1 An equalities impact assessment is not necessary as the report is primarily for information only.

7 CONSULTATION

7.1 This report is primarily for information and therefore consultation is not necessary.

8 ISSUES TO CONSIDER IN REACHING THE DECISION

8.1 The issues to consider are contained in the report.

9 ADVICE SOUGHT

9.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Alan South Technical and Compliance Manager (Tel: 01225 395283)
Background papers	*LGPS Regulations 2013 and The Pension Regulator: Code of Practice 14*
Please contact the report author if you need to access this report in an alternative format	

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Avon Pension Fund
Internal Disputes
Resolution Procedure [IDRP]

Dealing with Disagreements

Introduction

The Local Government Pensions Regulations 2013 have provisions included that specify the requirements for cases where there is a disagreement with a decision made or where a decision has not been made under the regulations.

Under the Pensions Regulator Code of Practice 14, Administering Authorities must make and implement dispute resolution arrangements that comply with the requirements of the Public Service Pensions Act 2013 to help resolve pension disputes

This document sets out the internal disputes resolution procedure on how the provisions of the regulations will be administered by Avon Pension Fund and its scheme employers.

The Pensions Ombudsman will not usually consider any applications until the IDRP has been completed.

Who can use IDRP?

The following can apply under the IDRP:

A member: who is paying contributions into the LGPS, or a retired member who receives a pension from Avon Pension Fund, or a former member who has left the scheme and their benefits are deferred with us.

A prospective member: an employee who although not a member yet, could become one if their employer brings them in you in, or they ask to join.

A dependant: the widow, widower, surviving civil partner or a cohabiting partner or a child of a member or prospective member

Using someone else to represent

Someone else can represent the applicant as they may not be able to put the case themselves, for example in the case of a child.

The applicant can, in this case choose someone else to represent them. This can be husband, wife, partner, a friend, relative, solicitor, union rep, etc.

First instance decisions

Any question concerning the rights or liabilities under the LGPS of any member or prospective member, are to be decided in the first instance as specified in the regulations as follows:

First Instance Decisions [regulation 72]	
Administering Authority	
(a)	**a person's previous service or employment**
(b)	**a person's previous service or employment the crediting of additional pension under regulation 16 (additional pension);**
(c)	**the amount of any benefit, or return of contributions, a person is or may become entitled to out of a pension fund.**
Scheme Employer	
must decide any question concerning any other matter relating to the person's rights or liabilities under the Scheme.	

Any decision made under this regulation must be made as soon as is reasonably practicable.

Whenever a decision is made about a member' or prospective member's pension, the member should be informed about it in writing.

Any notification must include details of the member's right to challenge the decision made.

Informal enquiry

Disagreements

An informal enquiry should be made for any initial disagreement the member has regarding a decision made. This should be raised with whoever is responsible for the decision either their employer or Avon Pension Fund. Many issues that members have are, in fact, resolved in this way. They may be caused by misunderstandings or wrong information, which can be explained or put right easily.

The scheme employer or Avon Pension Fund will try to deal with the enquiry as quickly and efficiently as possible.

Regardless of how the informal enquiry is made, any response must be made in writing and include full details of regulations used in making the decision, details of the next stage in the IDRP, and the name and position of the adjudicator to be contacted in the event that the disagreement is not resolved.

Formal Process

Adjudication of disagreements

Stage 1 [Regulations 74 and 75]

The Adjudicator

Each scheme employer and administering authority must appoint a person ("the adjudicator") to consider applications from any person whose rights or liabilities under the Scheme are affected by—

a) a decision under regulation 72 (first instance decisions); or

b) any other act or omission by a Scheme employer or administering authority, and to make a decision on such applications.

The adjudicator must determine—

a) the procedure to be followed when exercising functions under this regulation; and

b) the manner in which those functions are to be exercised.

Any formal application at stage 1 should be submitted on **form *IDRP S1*** to the adjudicator of whoever made the determination under the regulations from where the dispute occurred, either the employer or Bath and North East Somerset Council as the administering authority for Avon Pension Fund. If the employer is no longer participating in the Avon Pension Fund then applications should be made to Bath and North East Somerset Council.

The initial application must be made in writing within **six months** of the dispute taking place, as it can only be looked at after a longer period in special cases.

Any application under stage 1 must—

a) set out the applicant's name, address and date of birth;;

b) if the applicant is not a member of the Scheme, set out the applicant's relationship to any relevant member of the Scheme and give that member's full name, address, date of birth, national insurance number and the name of the member's Scheme employer;

c) include a statement giving details of the nature of the disagreement and the reasons why the applicant is aggrieved;;

d) set out the details of the grounds on which the applicant relies;

e) be accompanied by a copy of any written notifications for first instance decisions; and

f) be signed by or on behalf of the applicant.

The facts of the case will be examined, in accordance with LGPS regulations and any other legislation which is relevant. Further information may be requested to help in reviewing the case.

A written reply is to be sent within **two months** of the date the application is received. This reply should acknowledge receipt of the dispute, and explain the timescales for making a decision or notifying any delays.

When a decision is made, it must be made in writing and set out the disagreement, the relevant regulations and how any decision made was done so in accordance with the regulations.

The decision letter must also refer to the applicant's right to have the adjudicator's decision reconsidered under stage 2 of this procedure and how this can be done.

A copy of any decision made under stage 1 must be sent to Avon Pension Fund.

Reconsideration by the Administering Authority

If an applicant still disagrees with the outcome of **stage 1** (or hasn't had a reply in time) they may refer a decision of the adjudicator for reconsideration by the Avon Pension Fund under stage 2. *This is the case no matter who the original dispute was against.*

Stage 2: [Regulations 76 and 77]

An applicant may refer a decision for reconsideration by the appropriate administering authority.

Any application under stage 2 should be submitted on **form *IDRP S2*** and must—

a) be made before the relevant date;

> i. *in a case where notice of a decision has been given by the adjudicator six months from the date the notice is received;*
>
> *ii. in a case where an interim reply has been sent by the adjudicator, but no notice has been given, seven months from the expected decision date; and*
>
> *iii. in a case where no notice have been given and no interim reply sent by the adjudicator, nine months from the date on which the application was made.*

b) set out the applicant's full name, address and date of birth;

c) if the applicant is not a member of the Scheme, set out the applicant's relationship to any relevant member of the Scheme and give that member's full name, address, date of birth, national insurance number and the name of the member's Scheme employer;

d) include a statement that the applicant wishes the decision to be reconsidered by the administering authority;

e) set out the details of the grounds on which the applicant relies;

f) be accompanied by a copy of any written notifications for first instance decisions and decisions of the adjudicator; and

g) be signed by or on behalf of the applicant.

The Bath and North East Somerset must determine—

1) the procedure to be followed when exercising its functions under this regulation; and

2) the manner in which those functions are to be exercised, this may include seeking a review from an outside body before making a decision. No person who was involved in the making of a first-instance decision or a decision of the adjudicator can be involved in a decision on reconsideration.

The facts of the case will be examined, in accordance with LGPS regulations and any other legislation which is relevant. Further information may be requested to help in reviewing the case. The Stage 1 process should be looked at to consider whether it was carried out in accordance with the regulations

A written reply is to be sent within two months of the date the application is received. This reply should acknowledge receipt of the dispute, and explain the timescales for making a decision or notifying any delays.

When a decision is made, it must be made in writing and set out the disagreement, the relevant regulations and how any decision made was done so in accordance with the regulations.

The decision letter must also refer to the applicant's right to apply to the Pensions Ombudsman to challenge decisions made during the IDRP. Contact details for both the Pensions Ombudsman and The Pensions Advisory Service [TPAS] must be included in the final written response.

Cases where matter is referred back to a scheme employer

When, as part of the Stage 2 process, the matter is referred back to the employer to review their decision, any decision made by the employer whether or not there is any change to the original decision is subject to a possible further challenge under IDRP.

Following consultation with the Pension Ombudsman's Office either Stage 1 and/or Stage 2 could be waived and the matter referred straight to The Pension Ombudsman.

The employer would therefore be given the option of carrying out Stage 1 or waive it.

However, it seems appropriate that Stage 2 should always be completed, if only to ensure that any direction made in the original Stage 2 review has been carried out appropriately.

In such circumstances following discussions between their Monitoring Officer and Pension Section Bath and North East Somerset Council will decide who will carry out this Stage 2 review.

Forms IDRP S1 and S2 are included within the **Internal Resolution Dispute Procedure (IDRP): Guidance Notes for Members** which can be obtained from the Avon Pension Fund website at http://www.avonpensionfund.org.uk/customerservice/docs/HowtoComplain-20141128.pdf

Alternatively the Avon Pension Fund are able to send a copy by post on request.

The Avon Pension Fund will assist employers in understanding how to manage IDRP and if there is sufficient interest may from time to time provide employer training sessions.

As this procedure is subject to legislation which are subject to amendment from time to time, it will be regularly reviewed and any changes will be notified via member newsletters and the website.

Internal Disputes Resolution Procedure: Timeline

		Employer Initial Decision	Bath and North East Somerset Initial Decision
a	Informal enquiry Send to	Department at employer where original decision was made	Pension Section : Avon Pension Fund [APF] where original decision was made
b	Stage 1 Send to	Employer's Appointed Adjudicator On form IDRP S1 within 6 months of original decision	Bath and North East Somerset "Adjudicator" Technical and Compliance Manager [Pension Manager] On form IDRP S1 within 6 months of original decision
	Adjudicator	Reply to be made within 2 months or notify of any delay and give expected decision date Must notify APF of decision	Reply to be made within 2 months or notify of any delay and give expected decision date
c	Stage 2 Send to	Bath and North East Somerset Technical and Compliance Manager On form IDRP S2 within 6 months of Adjudicator's decision	Bath and North East Somerset Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) On form IDRP S2 within 6 months of Adjudicator's decision
	Bath and North East Somerset	Reply to be made within 2 months or notify of any delay and give expected decision date	
d	Pensions Ombudsman	If there is still a disagreement then an application can be made within a reasonable time to Pensions Ombudsman. The Pensions Advisory Service is available to assist with this and can also give advice during the IDRP process	

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Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**11 December 2015**
TITLE:	**WORKPLANS**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Appendix 1 – Investments Workplan to December 2016** **Appendix 2 – Pensions Benefits Workplan to December 2015** **Appendix 3 – Committee Workplan to December 2016** **Appendix 4 – Investments Panel Workplan to December 2016** **Appendix 5 – Training Programme 2015 - 2017**	

1 THE ISSUE

1.1 Attached to this report are updated workplans for the Investments and Pensions Benefit teams which set out the various issues on which work will be undertaken in the period through 2015-16 and which may result in reports being brought to Committee. In addition there is a Committee workplan which sets out provisional agendas for the Committee's forthcoming meetings.

1.2 The workplan for the Investment Panel is also included for the Committee to review and amend as appropriate.

1.3 The provisional training programme for 2015-17 is included as Appendix 5.

1.4 The workplans are consistent with the 2015 -18 Service Plan but also include a number of items of lesser significance which are not in the Service Plan.

1.5 The workplans are updated quarterly.

1.6 Member attendance at training events is recorded and reported annually in the Annual Report and Accounts. This will include a record of those members that have completed The Pension Regulators Knowledge and Skills Toolkit.

2 RECOMMENDATION

2.1 That the workplans and training programme for the relevant periods be noted.

3 FINANCIAL IMPLICATIONS

3.1 There are no financial considerations to consider.

4 THE REPORT

4.1 The purpose of the workplans is to enable members to have a better appreciation of their future workload and the associated timetable. In effect they represent an on-going review of the Service Plan while including a little more detail. The plans are however subject to change to reflect either a change in priorities or opportunities / issues arising from the markets. There are a number of workshops planned for 2016 included in the Committee workplan.

4.2 The workplans and training plan will be updated with projects arising when these are agreed.

4.3 The provisional training programme for 2015-17 is also included so that Members are aware of intended training sessions and workshops. This plan will be updated quarterly. It also includes a summary of the work the committee undertakes to meet the requirements of CIPFA's Knowledge and Skills Toolkit.

4.4 Please note that member attendance at training events is recorded and reported annually in the Annual Report and Accounts. This will include a record of those members that have completed The Pension Regulators Knowledge and Skills Toolkit.

5 RISK MANAGEMENT

5.1 Forward planning and training plans form part of the risk management framework.

6 EQUALITIES

6.1 An Equalities Impact Assessment has not been completed as the report is for information only.

7 CONSULTATION

7.1 N/a

8 ISSUES TO CONSIDER IN REACHING THE DECISION

8.1 N/a

9 ADVICE SOUGHT

9.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director - Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Woodyard, Investments Manager; 01225 395306 Geoff Cleak, Pensions Manager, 01225 395277
Background papers	None
Please contact the report author if you need to access this report in an alternative format	

Appendix 1

INVESTMENTS TEAM WORKPLAN TO DECEMBER 2016

Project	Proposed Action	Committee Report
Member Training	Implement training policy for members (and then officers) in line with CIPFA Knowledge and Skills Framework and Toolkit (when issued). Arrange training sessions as necessary to Ensure that all Committee members stay abreast of the latest developments in the world of local government pensions by being given the opportunity to attend seminars Training programme for new members in place	On-going
Review manager performance	Officers to formally meet managers as part of monitoring process See IP workplan for Panel meetings	Ongoing
Investment strategy & projects	Projects delegated to Panel for implementation or further investigation further. • Liability hedging – preliminary work started; bring to committee 2Q16 • Use of tactical ranges and "others" • RI Policy Review	In progress Panel reports 2Q16 Committee 3Q16
Pooling of investments	Participate in exploring options for pooling Initial Proposals required in 1Q16 Final proposals due 3Q16?	On-going
Monitoring of employer covenants	Annual monitoring of changes in employers financial position	On-going
Review AVC arrangements	Review choice of investment funds offered for members	2Q16
Review AAF 01/06 & SAS70 reports	Annual review of external providers internal control reports	Annually
Investment Forum	To discuss funding and investment strategies and issues	4Q16 following valuation?
Ill health insurance options	Investigate options for insuring ill-health pension costs for smaller employers	In progress
Pensions Board	Training plan	Ongoing
Document Management System	Create structure for document management system ready for using Council solution or alternative provider	Commence 1Q16 (dependent on corporate solution)
2016 Actuarial Valuation	As at 31 March 2016; Review Funding Strategy Statement (FSS)	Preparatory work starts 2Q16 Committee FSS workshop 2Q16

	Results to employers	from October 2016
Statement of Investment Principles	Revise following any change in Fund strategy/policies.	On-going
IAS 19	Liaise with the Fund's actuary in the production of IAS 19 disclosures for employing bodies	No report
Final Accounts	Preparation of Annual Accounts	Annually 2nd quarter

Appendix 2

PENSION ADMINISTRATION TEAM WORKPLAN TO 31 December 2016

Project	**Proposed Action**	**Report**
Employer Self Service rollout	Employer Self Service roll-out and training of all remaining employers to enable full electronic data delivery. Due completion March 2016	Ongoing
i-Connect software – to update member data on ALTAIR pension database automatically monthly	All Unitary Authorities Live On-boarding and set up of Avon Fire & UWE Market to other employers during 2015/16 once complete.	4Q15 4Q15 Commence 1Q16
Move to Electronic Delivery of generic information to members	Continue to move to electronic delivery to all members (other than those who choose to remain with paper). Campaign to increase the sign up of members to Member Self Service *(My pension online)*	Ongoing Ongoing
Successfully Implement New Fire Scheme Pension Reform	To follow through Project Plan to effectively implement and communicate the New Fire Scheme. Including staff training & member presentation sessions	Completed Completed
Historic Status 9 Cases (Old member leaver cases with no pension entitlement. Previously untraced)	Identify cases and contact former members (tracing agent) concerning pension refund payment.	Ongoing Completion due 16/17
TPR Requirements	Data Quality Management Control – ensure processes and reporting in place to reflect TPR compliance.	Process set up – Sept 15. Reporting qtly to Committee
Guaranteed Minimum Pension (GMP) Data Reconciliation Exercise Following cessation of Contracting out section April 2016	Carry out full reconciliation with HMRC records to mitigate risk from holding incorrect GMP liability	Ongoing Report to Committee March 2016
2014/15 Year End Process	Ensure complete data receipt from employers and carry out reconciliation process. Issue member ABS prior to 01/09/2015	Completed
Review Workflow & Data Processing	Implement new Task Workflow Arrangements. Introducing new software – Process Automation	Completion due 4Q15

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Appendix 3

Committee Workplan to 31 December 2016

MARCH 2016
Review of Investment Performance for Quarter Ending 31 December 2015
Pension Fund Administration –Performance Indicators for Quarter Ending 31 December 2015 and Risk Register Action Plan
Budget & Cashflow Monitoring 2015/16
Budget and Service Plan 2016/19
Audit Plan 2015/16
Scheme and Admitted Employer update
Managing Liability Risk
Review options for Ill health insurance for smaller employing bodies
Report on Investment Panel Activity
Workplans
Planned Workshops: Early March: Understanding the Funding Strategy Statement & Liability Driven Investing (full day)

JUNE 2016 (this meeting will have to start earlier due to length of agenda)
Roles & Responsibilities of the Committee
Agree draft Funding Strategy Statement
Framework for Liability Driven Investing
Pension Fund Administration – Performance Indicators for Year & Quarter Ending 31 March 2016 and Risk Register Action Plan
Budget & Cashflow Outturn 2015/16
Annual Review of Investment Strategy & Performance
Report on Investment Panel Activity
Annual Responsible Investing Report
Approval of draft Accounts 2015/16 and noting of audit plan
Approval of Committee's Annual Report to council
Review of AVC arrangements
Workplans
Planned Workshops: Morning of Committee meeting: Responsible Investing – setting the scene

Appendix 3

Committee Workplan to 31 December 2016

SEPTEMBER 2016
Review of Investment Performance for Quarter Ending 30 June 2016
Pension Fund Administration –Performance Indicators for Quarter Ending 30 June 2016 and Risk Register Action Plan
Budget & Cashflow Monitoring 2016/17
Report on Investment Panel Activity
Approval of Final Accounts 2015/16
Approval of Funding Strategy Statement
Review of AVC arrangements
Workplans
Planned Workshops: Responsible Investing

DECEMBER 2016
Review of Investment Performance for Quarter Ending 30 September 2016
Pension Fund Administration –Performance Indicators for Quarter Ending 30 September 2016 and Risk Register Action Plan
Budget & Cashflow Monitoring 2016/17
2016 Actuarial Valuation outcome
Report on Investment Panel Activity
Approval of Responsible Investing Policy
Workplans
Planned Workshops: Responsible Investing – agree policy and framework

Appendix 4

INVESTMENT PANEL WORKPLAN to December 2016

Panel meeting / workshop	Proposed agenda
Panel Meeting 18 November 2015	• Review managers performance to September 2015 • Use of tactical ranges within strategic asset allocation (flexibility to protect portfolio, take advantage of opportunities) • LDI – follow up
Meet the managers workshop 9 November 2015	• Meet the managers workshop o Genesis o Pyrford o RLAM o Unigestion
Panel Meeting Feb 2016 (TBA)	• Review managers performance to December 2015 • Framework for allocating to "Other Bonds" and "Other Growth" assets • Managing liabilities – further work Workshop: Meet the managers
Panel meeting May 2016 (TBA)	• Review managers performance to March 2016 • AVC Review • Managing liabilities – agree recommendation to Committee Workshop: Meet the managers
Panel meeting 3Q16 (TBA)	• Review managers performance to June 2016 Workshop: Meet the managers
Panel meeting 4Q16 (TBA)	• Review managers performance to September 2016 Workshop: Meet the managers

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Appendix 5

Committee training programme 2015-17

	Topic	Content	Format	Timing
1	Governance	Overview of governance structure Overview of Fund LGPS Scheme Advisory Board The Pensions Regulator Codes Agenda for June Committee meeting	Committee Workshop	Morning of June 2015 Committee meeting
2	Overview of Fund Strategies	Scheme outline and structure Administration Strategy Communications Strategy Risk Register	Committee Workshop	Morning of 25 September 2015 Committee meeting
3	Actuarial Valuations	Valuation methodology Recap on 2013 valuation 2015 interim valuation outcome LGPS Cost Cap Mechanism	Committee Workshop	12 October 2015
4	Funding Strategy Statement, covenants, admission and exit policies	Funding Strategy and 2016 valuation Covenant assessment process Admission and exit policies and funding basis used	Committee Workshop	2Q 2016
5	Investment strategy	Asset allocation & Statement of Investment Principles Investment strategies e.g. active vs. passive Investment management structure Process for appointing managers Monitoring managers and performance measurement Fees	Investment Panel Workshop	Morning of 11 September 2015 Panel meeting (and on adhoc basis)
6	Managing liabilities	Understanding objective Potential solutions Impact on bond portfolio Impact on funding level Proposed framework Recommendation: Objective and proposed framework	Investment Panel meetings Committee Meeting	 June 2016
7	Responsible Investing	Objective and rationale Review Current policy	Committee Workshop	Workshops through 2016

Training Programme and the CIPFA Knowledge & Skills Framework (2015/16)

Topic	Related CIPFA Knowledge & Skills Framework areas:	Timing
Fund Governance and Assurance	Legislative & Governance, Auditing & Accounting Standards, Procurement & Relationship Management	June committee meeting (through committee paper on responsibilities and new committee training); introductory workshops
Manager selection and monitoring	Investment Performance & Risk Management	Ongoing by Panel in quarterly monitoring of manager performance Annual report to Committee by Investment Consultant (June Committee meeting)
Asset Allocation	Investment Performance & Risk Management, Financial Markets & Products	On-going through monitoring of strategy, Workshops on investing in different assets, strategic allocation e.g. Liability investing, responsible investing
Actuarial valuation and practices	Actuarial Methods, Standards and Practices	Funding update reports quarterly to Committee 2015 interim valuation workshop; valuation, covenant and funding policies workshop