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PENSION FUND COMMITTEE & PENSION BOARD WEDNESDAY, 23 MARCH, 2016

A JOINT MEETING of the PENSION FUND COMMITTEE AND PENSION BOARD will be held in the COUNCIL CHAMBER, COUNCIL HEADQUARTERS, NEWTOWN ST BOSWELLS on WEDNESDAY, 23 MARCH 2016 at 10.00 am

J. J. WILKINSON,
Clerk to the Council,

16 March 2016

BUSINESS		
1.	**Apologies for Absence**	
2.	**Order of Business**	
3.	**Presentation - Cash Flow Modelling** Presentation by Alison Hamilton, Barnett Waddington LLP	30 mins
4.	**Declarations of Interest**	
5.	**Minute** (Pages 3 - 8) Minute of Meeting held on 10 December 2015 to be noted and signed by the Chairman. (Copy attached).	2 mins
6.	**Risk Register Update** (Pages 9 - 18) Consider report by Chief Financial Officer. (Copy attached).	10 mins
7.	**Currency Hedge** (Pages 19 - 32) Consider report by Chief Financial Officer. (Copy attached).	10 mins
8.	**Review of Additional Voluntary Contributions** (Pages 33 - 36) Consider report by Chief Officer Human Resources. (Copy attached).	10 mins
9.	**Proposed Admission to the Local Government Pension Scheme** (Pages 37 - 42) Consider report by Chief Officer Human Resources. (Copy attached).	10 mins
10.	**LGPS Pooled Investment Infrastructure** (Pages 43 - 44) Consider briefing paper by Chief Financial Officer. (Copy attached).	5 mins

11.	**Scheme Advisory Board Bulletin** (Pages 45 - 46) Consider Scheme Advisory Board Bulletin, (Copy attached).	5 mins
12.	**Training Opportunities** Consider update from Capital and Investment Manager.	5 mins
13.	**Any Other Items Previously Circulated**	
14.	**Any Other Items which the Chairman Decides are Urgent**	
15.	**Items Likely To Be Taken In Private** Before proceeding with the private business, the following motion should be approved:- "That und Section 50A(4) of the Local Government (Scotland) Act 1973 the public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 8 of Part 1 of Schedule 7A to the aforementioned Act."	
16.	**Minute** (Pages 47 - 48) Private Section of Minute of Meeting held on 10 December 2015 to be noted and signed by the Chairman. (Copy attached).	2 mins
17.	**Quarter Performance Update** (Pages 49 - 86) Consider report by Mr Kenneth Ettles. AON Hewitt. (Copy attached).	30 mins
18.	**Pension Fund Appointment Sub-Group** (Pages 87 - 88) Private Minute from Pension Fund Appointment Sub-Group on 2 February 2016 to be noted. (Copy attached).	2 mins
19.	**Procurement Update** Report to follow.	10 mins

NOTES

1. **Timings given above are only indicative and not intended to inhibit Members' discussions.**

2. **Members are reminded that, if they have a pecuniary or non-pecuniary interest in any item of business coming before the meeting, that interest should be declared prior to commencement of discussion on that item. Such declaration will be recorded in the Minute of the meeting.**

Membership of Committee:- Councillors B White (Chairman), J. Campbell, M. J. Cook, G. Edgar, G. Logan, J. G. Mitchell, S. Mountford and S. Aitchison (Co-Chair)

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SCOTTISH BORDERS COUNCIL
PENSION FUND COMMITTEE
AND PENSION BOARD

MINUTE of Meeting of the PENSION FUND COMMITTEE AND PENSION BOARD held in Council Chamber, Council Headquarters, Newtown St Boswells on Thursday, 10 December, 2015 at 9.30 am

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Present:- Councillors J Mitchell (Chairman), J Campbell, M Cook, G Edgar, G Logan, S Mountford, Mr A Barclay, Ms R Black, Mr M Drysdale, Mr P Smith.

Apologies:- Councillors: S Aitchison, B White, Ms Linda Ross.

In Attendance:- Chief Financial Officer, HR Shared Services Manager (Items 1-3) Treasury & Capital Manager, Chief Officer Audit & Risk, Mr K Ettles – AON Hewitt Consulting, Democratic Services Officer (J Turnbull).

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1. **ORDER OF BUSINESS**

The Chairman varied the order of business as shown on the agenda and the Minute reflects the order in which the items were considered at the meeting.

2. **MINUTE**

There had been circulated copies of the Minute of the Meeting of 3 September 2015.

DECISION:
NOTED for signature by the Chairman.

3. **COMMUNICATION STRATEGY**

Mr Ian Angus, HR Shared Services Manager was in attendance to give a briefing on the implementation of a Communications Strategy. Within the Pension Fund Business Plan it had been agreed that the Fund would develop and gain approval for the implementation of a Communications Strategy and Action Plan during 2015/16. The Strategy would consider engagement with existing scheme members and information made available to potential scheme members. Additionally, communication with Scheduled and Admitted Body employers would be explored and provision of access to relevant forms and documents they required to provide a quality service to their employees. Mr Angus advised that the Council's Communications team would provide their skills and expertise to assist with the development of the Action Plan and Strategy. The first decision required was the most appropriate place for hosting the Pension Fund information. There were a number of options to consider: SBC's website; a new website specifically for the Pension Fund; Self Service site for the Pension Administration system; or, the new Staff Benefits portal. Once these options had been appraised a further report would be brought to a meeting of the Pension Fund Committee and Pension Board for consideration. In answer to a question regarding regular Freedom of Information (FOI) requests, Mr Robertson advised that FOIs were not presently charged, the cost being met within officer time. Mrs Robb added that publication of a list of Fund holdings would be considered, any FOI requests for this information could then be directed to the appropriate section on the website.

DECISION
NOTED
(a) Progress on the implementation of a Communication Strategy; and

(b) That a further report on the Communications Strategy would be presented to a future joint meeting of the Pension Fund Committee and Pension Board.

MEMBER
Councillor Cook joined the meeting during consideration of the above item**.**

4. **RISK REGISTER UPDATE**

4.1 With reference to paragraph 6 of the minute of 3 September 2015, there had been circulated a report by the Chief Financial Officer providing Members of the Committee and Board with an update on the progress of management actions to mitigate risks, a review of new risks and highlighting changes to any of the risks contained in the Risk Register**.** Identifying and managing risk was a corner stone of effective management and was required under the Council's Risk Management Policy process guide and CIPFA's guidance "Delivering Governance in Local Government Framework 2007". It was further reflected and enhanced in the "Local Government Pension Scheme" published by CIPFA. Appendix 1, to the report detailed the risks within the approved Risk Register. In line with the Council's Risk Management Policy (2015) a paper would be presented to the June 2016 meeting demonstrating progress with a fully reviewed Risk Register, including consideration of any new risks. It was noted that a full Risk Workshop had been undertaken on 3 September 2015 to ensure that the Risk Register's content was up to date and no new risks had been identified.

4.2 Mr Robertson advised that there had been discussion at UK national level on the pooling of pension funds and a drive to increase investment in infrastructure. Officers were undertaking further work to evaluate possible implications for the Pension Fund and would report back to the Committee and Board at the March 2016 meeting. Mr Robertson referred to Risk 4.1, that changes to the composition of the Pension Fund membership might lead to there being insufficient assets in the Fund to meet future liabilities. Mr Robertson explained that this was indicative of the Fund maturing. There followed a discussion on the long term consequences of Early Retirement Voluntary Service (ERVS) in relation to the Fund. If this policy continued it was considered that it would have a significant impact on the Fund going forward. It was important to encourage younger employees to join the Fund to offset the number of Fund members retiring early. In answer to questions, Mr Robertson clarified that the Actuary's methodology, calculated what was expected in terms of loss to the Pension Fund when requests for ERVS were considered by Council. The Pension Fund was then compensated based on the Actuary's calculation. Mr Robertson highlighted that changes to the cash requirement of the Fund to pay pensions altered the structure of the Fund, it was therefore essential to ensure the correct balance of liquid and illiquid assets. Mr Robertson suggested that the Actuary be invited to a meeting of the Committee and Board to give a presentation on the impact of ERVS on the Pension Fund and this was welcomed. It was noted that Risk 4.1 and Risk 2.5 were connected and Mr Robertson would look at the future presentation of these two risks on the Risk Register.

DECISION

(a) AGREED

(i) To the additional actions proposed in Appendix 1 to the report;

(ii) To a full review of the Risk Register being undertaken in June 2016 to include progress on risk management actions and consideration of any new risks; and

(ii) To receive a presentation by the Actuary on the impact of ERVS on the Pension Fund.

(b) NOTED

(i) The management actions progress as contained in Appendix 1, to the report;

(ii) That further information would be provided at the March 2016 meeting on the pooling of funds and infrastructure investments; and

(iii) No new risks had been identified since the last review.

5. **BUSINESS PLAN PERFORMANCE UPDATE**

There had been circulated a report by Chief Financial Officer providing members of the Committee and the Board with an update on the actions within the approved Business Plan. The 2015/16 – 2017/18 Business Plan for the Pension Fund was approved by the Committee and Board on 18 June 2015. Included within the Plan were key objectives and actions with target dates. As part of the risk register update, approved at the Committee and Board on 3 September, it was agreed a mid-year progress report on the Business Plan actions would be presented to Members at the December meeting and a further progress report and update at the June 2016 meeting. There were 13 performance measures with target dates during 2015/16 contained within the Business Plan. These were detailed in Appendix 1 to the report. As at 10 December, six performance measurements had been completed, six were on track to complete within their targeted timescales and one was currently behind target but progressing.

DECISION

(a) **AGREED a further update be presented at the June 2016 meeting; and**

(b) **NOTED the progress of the 2015/16 actions with the Business Plan.**

MEMBER

Councillor Campbell joined the meeting during consideration of the above item.

6. **PROCUREMENT UPDATE**

6.1 There had been circulated a report by Chief Financial Officer providing Members with an update on the various procurement activities to be undertaken for the Pension Fund over the next 12 months. Identified within the Business Plan, approved by Committee on the 18 June 2015, there were three procurements to be undertaken. These were Investment Advisor, Custodian and Currency Manager. The current split of services procured by the Fund required to be reviewed prior to the commencement of the procurements to ensure the Fund could meet its statutory reporting requirements and ensure best value from all services was obtained. The Appointments Sub-Committee would work with officers during the procurements and make recommendations to the Pension Fund Committee and Board on the individual preferred bidders. To reduce timescales, without adversely affecting the quality of the procurement, it was proposed for the Investment Advisor and Custody services to use the Norfolk Framework. To reduce timescales for the currency hedge manager an Investment Management Agreement (IMA) was being developed. This would reduce the risks and time required for clarifications and final contract award.

6.2 In answer to questions, Mr Robertson explained that the current Custodian provided a limited service, augmented with quarterly performance reports provided from Aon Hewitt. This arrangement had worked well for the fund in the past. However, due to increased complexity of the statutory reporting requirements and the increased number of fund managers there was a need to review the current service procured. The use of the Norfolk framework would allow for a shortened procurement exercise without affecting the quality of the procurement check. It was proposed that the procurement process would commence in January with the shortlisted companies being considered by the Appointments Sub Committee in March. Recommendations would then be presented to the Pension Board and Pension Fund Committee on 23 March 2016.

DECISION

(a) AGREED

(i) The use of the Norfolk framework for the Investment Advisor and Custody procurements; and

(ii) The payment of the joining fees.

(b) NOTED further reports and updates would be provided at the March meeting.

MEMBER
Councillor Edgar left the meeting prior to consideration of the above item.

(Note: Mr K Ettles, Aon Hewitt, left the meeting during consideration of the above item.)

7. **EMPLOYER CESSATIONS**
There had been circulated a briefing paper by Chief Financial Officer providing members of the Committee and the Board with an update on the current issue some pension funds were facing with cessations and explaining the national discussion around these. Under the Local Government Pension Scheme (Scotland) Regulations 2014 there were certain circumstances where revised actuarial valuations and certificates must be obtained. This included where a scheme employer ceased to be part of the scheme or no longer had active members contributing to the fund. The Employer became an "exiting employer" under the regulations and was liable to pay an exit payment. For each "exiting employer" the administering authority must obtain an actuarial valuation of the liabilities, as at the exit date, in respect of the employer's current and former employees. This valuation revised contribution rates and provided an exit payment in respect of the benefits liability. To ensure the Pension Fund was not at risk for these liabilities the "exiting employer" was then required to either pay the exit payment or provide an indemnity, bond or guarantee. Mr Robertson explained that there were issues around the unintended consequences of the changes to the regulations in terms of "exiting employers". Concerns had been raised by the "exiting employers" regarding the impact and the value of the required payment in relation to the organisations' total budget. Scottish Government would ensure that changes to the regulations to assist both administering bodies and "exiting employers" would be in force in December 2015. However, the Deputy First Minister's letter, a copy of which was attached to the Agenda, instructed cognizance of the changes now when considering any cessation liabilities. In answer to questions, Mr Robertson clarified that an "exiting employer" referred to a body that had been admitted to the fund but had no new active members. There were currently seven employers within the Pension Fund who had no active members, deferred members in this category being 0.36% of the total membership. Mr Robertson advised that the briefing paper had been brought for information, when further details were available a further report would be presented to the Committee and Board.

DECISION
NOTED.

8. **SCHEME ADVISORY BOARD – WORK PLAN**
There had been circulated copies of the Scheme Advisory Board Bulletin together with the Pension Fund Statement of Investment Principles 2013 and 2015, for information.

DECISION
NOTED.

9. **INVESTMENT IN INFRASTRUCURE**
There had been circulated copies of correspondence from the Local Government and Regeneration Committee of the Scottish Parliament – Response by Scottish Borders Council. In addition, copies of the Report on Pension Fund Investment in Infrastructure and City Deal Spend had also been circulated. The documentation explained that Scottish Parliament's Local Government and Regeneration Committee had sought information on investments made and any current barriers to investing in infrastructure projects and city or region deals. As well as the submission provided from Scottish Borders Council (SBC) to the Committee, Mr Robertson had been invited to give evidence in terms of the operation and ability of the Scottish Borders Pension Fund and in particular investment in infrastructure. Mr Robertson advised that when given evidence, he had highlighted, the legal difference between pension funds and the local authority and the tension between maximising pension fund returns and infrastructure investment by the

Council. He had also explained that the Committee, in noting that there were significant assets in pension funds, should also remember there were considerable liabilities. The Pension Fund Committee and Pension Board discussed the report and unanimously agreed that their role was to maximise returns in relation to the Pension Fund, to protect the interest of the Pension Fund and the membership. Mr Robertson advised that the Pension Fund Committee and Pension Board would be kept updated for a response to be made, if required.

DECISION
NOTED.

10. **ITEM LIKELY TO BE TAKEN IN PRIVATE**
DECISION
AGREED under Section 50A(4) of the Local Government (Scotland) Act 1973 to exclude the public from the meeting during consideration of the business contained in the following items on the ground that they involved the likely disclosure of exempt information as defined in paragraphs 6 and 8 of the part 1 of Schedule 7A to the Act.

SUMMARY OF PRIVATE BUSINESS

11. **MINUTE**
The Committee noted the Private Minute of the meeting of 3 September 2015.

12. **QUARTER PERFORMANCE UPDATE**
The Committee noted a report by AON Hewitt Consulting.

13. **PROPERTY INVESTMENT UPDATE**.
There Committee noted a report by Chief Financial Officer.

The meeting concluded at 12.00 pm

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RISK REGISTER UPDATE

Report by Chief Financial Officer

JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION BOARD

23 March 2016

1 PURPOSE AND SUMMARY

1.1 **This report forms part of the risk review requirements and provides the Members of the Pension Fund Committee and Pension Board with an update of the progress of the management actions to mitigate the risks, a review of any new risks and highlights changes to any of the risks contained in the risk register.**

1.2 Identifying and managing risk is a corner stone of effective management and is required under the Council's Risk Management Policy and process guide and CIPFA's guidance "Delivering Governance in Local Government Framework 2007". It is further reflected and enhanced in the "Local Government Pension Scheme" published by CIPFA.

1.3 Appendix 1 details the risks within the approved Risk Register which have identified management actions and the progress of these actions to date.

1.4 In line with the Council's Risk Management Policy (2015) a paper to be presented at the June 2016 meeting will demonstrate progress regarding actions and present a fully reviewed risk register including consideration of any new risks.

2 RECOMMENDATIONS

2.1 **It is recommended that the Committee and Board:-**

(a) Notes the management actions progress as contained in Appendix 1

(b) Notes no new risks have been identified since the last review.

(c) Agrees to a full review of the risk register being undertaken in June 2016 to include progress on risk management actions, and consideration of any new risks.

3 BACKGROUND

3.1 Identifying and managing risk is a corner stone of effective management and is required under the CIPFA guidance "Delivering Governance in Local Government Framework 2007". It is further reflected and enhanced in the "Local Government Pension Scheme" published by CIPFA.

3.2 The Risk Register has been developed in line with the Council's approach to risk management as set out in the "Risk Management process guide" and assesses risks using a risk score based on likelihood and impact. It has been further refined to reflect best practice "Managing Risk in the Local Government Pension Scheme" published by CIPFA.

3.3 The Pension Fund's Business Plan 2015/16 – 2017/18 was approved on 18 June 2015 and set out the aims and objectives of the Pension Fund. These aims and objectives were fully considered and recognised in the formation and approval of the Pension Funds risk register.

3.4 The Council's revised Risk Management process guide uses the following risk scoring:

Level of risk	Risk score
RED	High –Risk Score Range 15-25
AMBER	Medium – Risk Score Range 6 – 12
GREEN	Low – Risk Score Range 1 - 5

3.5 To comply with the Council's revised policy of risk management and best practice a Risk Management reporting cycle was developed around the performance and business plan reporting of the Pension Fund. As a result the following cycle of reporting was adopted:

Quarterly
- Quarterly Investment Performance Report
- Key risks, escalation of any risks that are perceived to have changed adversely and any new risks need to be considered by the Committee.
- Update on progress of risk management action delivery

Bi-Annually
- Mid-Year Progress report on Business Plan Actions
- Key risks, escalation of any risks that are perceived to have changed adversely and any new risks need to be considered by the Committee.
- Update on progress of risk management action delivery

Annually
- Annual Governance Meeting with Annual Report and Policy/Strategy Performance Reports
- Annual reporting on progress with Business Plan and approval of updated Business Plan
- Annual reporting on progress with Risk Management Actions and approval of fully reviewed Risk Register including consideration of any new risks

4 RISK REGISTER UPDATE

4.1 A full risk workshop was undertaken on 3 September 2015 in order to ensure that the risk register's contents were still relevant and up-to-date. The outcome of the workshop was then approved at the Committee/Board meeting**.** The Bi-annual review and update of the management actions was presented to Committee/Board on 10 December 2015. This report provides the quarterly review of risks and progress on the progress of the actions. The quarterly investment performance report is presented on the agenda as a separate report.

4.2 The progress of the individual management actions identified in the current risk register are detailed in Appendix 1.

4.3 There has been discussion at UK national level on the pooling of pension funds and drive to increase investment in infrastructure. Officers are currently undertaking further work to assess the possible implications for the Pension Fund. A briefing paper has been included on the agenda providing an update on the progress of pooling in England and Wales. There are however still a number of areas of uncertainty and it's unknown how or if this will affect the Scottish funds.

4.4 No new risks have been identified since the approval of the risk register on 3 September 2015. The risks previously identified and scored at the September workshop remain unchanged.

5 IMPLICATIONS

5.1 **Financial**

There are no direct financial implications of this report.

5.2 **Risk and Mitigations**

(a) The purpose of providing the update to the Committee and Board is as part of improving the risk management framework for the Pension Fund to demonstrate that the Members of the Pension Fund Committee and the Pension Board understand the risks faced and how it is proposed to manage, mitigate or tolerate these risks. The Additional Proposed Actions as contained in Appendix 1, and recommended for approval by the Committee and Board in this report, are designed to directly enhance the management of risks.

(b) The Chief Officer Audit and Risk has commented that there is a substantial framework for effective management of risks relating to the Pension Fund (i.e. the business plan objectives, clear governance arrangements, regular monitoring, risk register, etc.) Some minor areas of improvement to process identified and these will be incorporated into the full review of the Pension Fund risk register to be undertaken in June 2016.

5.3 **Equalities**

It is anticipated that there are no adverse impact due to race, disability, gender, age, sexual orientation or religion/belief arising from the proposals in this report.

5.4 **Acting Sustainably**

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

5.5 **Carbon Management**

There are no direct carbon emissions impacts as a result of this report.

5.6 **Rural Proofing**

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

5.7 **Changes to Scheme of Administration or Scheme of Delegation**

No changes to the Scheme of Administration of Scheme of Delegation are required as a result of this report.

6 CONSULTATION

6.1 The Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk, the Chief Officer HR and the Clerk to the Council have been consulted and their comments included in the report.

Approved by

David Robertson
Chief Financial Officer **Signature .....**

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Treasury & Capital Manager, 01835 825249

Background Papers:
Previous Minute Reference: Pension Fund Committee and Pension Board 10 December 2015

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Treasury & Capital Team can also give information on other language translations as well as providing additional copies.

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APPENDIX 1

Pension Fund - Risk Register

							Controls		Residual Risk			Progress
No.	Category	Risk	Causes/Triggers	Consequences	Proximity	Risk Owner	Current Controls	Control Assessment	Impact	Likelihood	Score	Actions as at 23/03/2016
1.1	Asset & Investment	Failure to achieve the target investment returns set out in the Statement of Investment Principles over the longer term may lead to significant increased employer contribution rates and costs of implementing changes to the investment strategy.	Inappropriate strategic asset allocation for Fund's requirements; Inappropriate investment approaches within asset class; Underperformance/ negative investment returns from investments under management; Significant and sustained market and economic events creating adverse movements in valuations; Investment Strategy Inconsistent with Funding Strategy.	Significant rises in the employer contributions; Costs involved in implementing changes to investment strategy; Funding Deficit for Fund.	Ongoing	Pension Fund Committee/ Chief Financial Officer	Continual monitoring of investment performance; Engagement with Investment Adviser to update investment strategies and periodic review of strategic asset allocation; Scrutiny of Investment Manager performance by Investment & Performance Sub-Committee Actuary reports included element of prudence *TOLERATE* Additional Actions Proposed: Enhance officer role in monitoring of investment returns to enable more timely action to be taken. Encourage more thorough challenge of Advisers and Fund Managers. Extension of time to UBS to December 2016 for repositioning of property mandate.	Effective	4	3	12	Training requirements being actioned as part of Training plan to ensure Members have required skills and knowledge to enable challenge.
1.4	Asset & Investment	Failure to take expert advice or risk of poor investment/actuarial advice may lead to the Fund's assets not being properly managed resulting in inappropriate investment decisions and poor returns and/or insufficient funding levels	Committee ignores advice provided by expert adviser; External adviser provides inappropriate/inaccurate/ insufficient advice to Committee/Officers	Fund takes wrong or inappropriate decisions in relation to proper management of the Fund resulting in inadequate investment returns and/or insufficient funding levels potentially increasing employers contribution rates.	Ongoing	Pension Fund Committee/ Chief Financial Officer	Robust procurement processes around the recruitment and appointment process; Continual review of Investment Adviser/Actuary performance; Benchmark performance against other LAs; Regular benchmarking and cross verification of advice with other local authorities through the Local Government Pension Scheme(Scotland) Investment & Governance Group; Use other information sources and discussions with non-Fund investment managers/advisers to validate advice and performance of Fund; Use independent Performance monitoring company; Utilise independent performance monitoring service to provide an independent annual review/health check to the Investment & Performance Sub-Committee. Introduction of Pension Board providing scrutiny role. TOLERATE Additional Actions Proposed: Ongoing training for elected members of the Pension Board and Committee.	Effective	4	2	8	Training requirements being actioned as part of Training plan to ensure Members have required skills and knowledge to enable challenge.
1.5	Asset & Investment	Failure to manage Currency risk may lead to an inability to maximise the returns from investments with the agreed risk parameters resulting in an adverse impact on valuation of investment assets and assessment of Fund's future liabilities	Adverse movements in market/economic conditions impacting on currency rates	Adverse impact on valuation of investment assets and assessment of Fund's future liabilities	Ongoing	Chief Financial Officer	Passive Currency hedge in place for directly held equity investments on major currencies; Monthly review of hedge levels. *TREAT* Additional Actions Proposed: Procurement of a dynamic currency hedge mandate for an element of the directly held equity investment	Partially Effective	3	4	12	Investment Management Agreement almost complete to allow procurement to commence in the New Year
1.9	Asset & Investment	Investment Strategy is inconsistent with Funding Strategy may lead to the fund not being managed properly through setting employer contribution rates incorrectly resulting in the future liabilities of the Fund not being able to be covered by its assets and requiring employers to increase contribution rates to address any funding gap.	Investment Strategy for Fund set without appropriate consideration of the requirements of the Funding Strategy	Fund not being managed properly setting employer contribution rates incorrectly resulting in the future liabilities of the Fund not being able to be covered by its assets and requiring employers to increase contribution rates to address any funding gap.	Ongoing	Pension Fund Committee/ Chief Financial Officer	Full actuarial valuation undertaken on Triennial basis. Funding Strategy Statement and Statement of Investment Principles updated and approved at the same time. As part of this assess requirement for Investment strategy to be reviewed and updated accordingly. *TOLERATE* Additional Action Proposed: Undertake a full investment strategy review following 2014 valuation.	Effective	2	2	4	Tenders received and evaluated for Investment Advisor. Paper to Committee/Board on 23rd March with recommendation for award.

Pension Fund - Risk Register

							Controls		Residual Risk			Progress
No.	Category	Risk	Causes/Triggers	Consequences	Proximity	Risk Owner	Current Controls	Control Assessment	Impact	Likelihood	Score	Actions as at 23/03/2016
1.10	Asset & Investment	Failure of Funds investment returns to keep pace with pay and CPI Inflation increases may lead to Funding Levels falling and potentially requiring increases in employer contribution rates.	General economic climate results in higher CPI inflation and investment returns do not keep pace due global investment markets and economy's	Funding levels fall, SBC pay more contributions into Fund	ongoing		Continual monitoring of investment performance; Engagement with Investment Adviser to update investment strategies and periodic review of strategic asset allocation and introduction of other asset types. Regular dialogue with Fund Actuary; Actuary attendance at Pension Fund Committee on an annual basis between triennial valuations. *TREAT* - Action Proposed continued monitoring and evaluation of inflation and pay awards	Effective	3	4	12	Work plan and information requirements currently being developed in conjunction with other Employers. Work completed by Actuary for cashflow projections, to be presented to Committee/Board on 23rd March.
2.5	Employer	Failure to understand and be involved in proposed structural changes in employers' engagement in the Scheme may lead to failure to manage the transition to a different level/type of participation by the employer in the Fund resulting in inappropriate employer contribution rates and insufficient management of contributions to cover future liabilities of that employer.	Failure to understand and be involved in proposed structural changes in employers' engagement in the Scheme. Fund participation no longer affordable to an employer.	Failure to manage the transition to a different level/type of participation by the employer in the Fund resulting in inappropriate employer contribution rates and insufficient management of contributions to cover future liabilities of that employer. Fund reaches maturity more quickly; Adverse impact on cash flow and funding levels (per risk 4.1)	Ongoing	Pension Fund Committee/ HR Shared Services Manager	Annual Employers Liaison group established to improve two-way communication; Borders College and 2 Admitted Bodies representatives on Pension Board; Full actuarial valuation undertaken on Triennial basis; Active involvement of actuary in projects affecting membership structures: Low number of admitted and scheduled bodies and any new admitted bodies are carefully considered before admission. *TOLERATE* Additional Action Proposed: Full communications strategy being developed during 2016/17 to further improve Employer Engagement	Effective	2	3	6	Communication strategy currently being developed in conjunction with Communication Team.
3.1	Resources & skills	Over reliance on key officers may lead to significant knowledge gaps resulting in failure to manage the Fund effectively.	Over reliance on key individual officers and/or absence of succession management in relation to supporting crucial aspects of the operation of the Fund.	May lead to significant knowledge gaps resulting in failure to manage and operate the Fund effectively.	Ongoing	Chief Financial Officer/ Chief Officer Human Resources	Use of external advisers (investment/tax/SPPA) provides additional resilience and resources. New pension administration system implemented which includes help modules in built which can be enhanced to include details specific to SBC Pension Fund; Restructure of teams to ensure no single point of failure and manage succession planning. *TOLERATE* Additional Action Proposed: Improvement in quality of procedure notes for officers.	Effective	2	3	6	Acton plan for the development and updating of procedure notes currently being developed. Will prioritise for perceived high risk and possible quick wins.
3.7	Resources & skills	Failure of Officers to maintain sufficient level of competence to discharge their duties could lead to failure to manage the Fund effectively as a result of their inability to provide appropriate decision making support and advice.	Failure of Officers to maintain sufficient level of competence to discharge their duties. Lack of documented procedures.	Failure to manage the Fund effectively as a result an inability of officers to provide appropriate decision making support and advice.	Ongoing	Chief Financial Officer/ Chief Officer Human Resources	Use of External Advisers provides additional resilience and resources; PRD process implemented to identified training and development requirements; Active participation in Scottish Investments and Governance Group (IGG) and Scottish Pensions Liaison Group; Regular engagement with external Investment Managers to supplement knowledge. *TREAT* Additional Action Proposed: Improvement in quality of procedure notes for officers.	Partially Effective	2	3	6	Acton plan for the development and writing of procedure notes currently being developed. Will prioritise for perceived high risk and possible quick wins.

Pension Fund - Risk Register

							Controls		Residual Risk			Progress
No.	Category	Risk	Causes/Triggers	Consequences	Proximity	Risk Owner	Current Controls	Control Assessment	Impact	Likelihood	Score	Actions as at 23/03/2016
4.1	Liquidity	Changes in composition of Pension Fund membership i.e. active/ deferred/ pensioners may lead to there being insufficient assets in the Fund to meet the future liabilities as they fall due potentially increasing employers contribution levels and changes to the investment strategy.	Changes in composition of Pension Fund membership i.e. active/deferred/pensioners. (risk identified in 2.5)	Fund Matures more quickly than currently anticipated and may lead to there being insufficient assets in the Fund to meet the future liabilities as they fall due potentially increasing employers contribution levels and changes to the investment strategy.	Ongoing	Chief Financial Officer	Funding Strategy Statement, Statement of Investment Principles and Triennial Valuation all work together to identify funding requirements and how these are met; Use of an Investment Adviser and Actuarial services as and when required. Implementation of Auto-enrolment with final transition being completed by July 2017; Pension Administration Strategy in place and monitored and Employer Liaison Group. Annual Report includes analysis membership changes. *TREAT* Additional Actions Proposed: Close monitoring of early retiral decisions and quantification of impact on pension fund being included as part of the Council reports; Review to be undertaken of cashflow scenarios to identify timelines and impact of changing legislation.	Partially Effective	4	4	16	Work plan and information requirements currently being developed in conjunction with other Employers. Work completed by Actuary for cashflow projections, to be presented to Committee/Board on 23rd March.
4.2	Liquidity	Employees can no longer afford to participate in the scheme then there may be reduced income into Fund resulting in a change being required to the Funding and Investments Strategy due to changes in participation levels.	Employees can no longer afford to participate in the scheme due economic environment or increase employee contribution rates.	Reduced income into Fund resulting in a change being required to the Funding and Investments Strategy due to changes in participation levels.	Ongoing	Chief Financial Officer	Limited measures in place. Nationally negotiated rates/benefits with employee representatives (i.e. Trade Unions) on minimising employee contribution increases; Pay awards now being given, economy now improving; LGPS changes implementation of 50/50 option; Trade Union involvement in the Pension Board and Scheme Advisory Board. Communication issued with annual benefits statements *TREAT* Additional Actions Proposed: Ensure regular information is issued to employees setting out the continued benefits of scheme membership e.g. tax relief on contributions/employers contribution; Communication strategy being developed.	Partially Effective	4	3	12	Being developed as part of communication strategy in conjunction with Communication Team.
4.9	Liquidity	Failure to manage the liquidity required for the Fund's cashflows may lead to assets being sold at unattractive times or investment opportunities are missed due to unavailability of cash resulting in an adverse impact on the valuation of the Fund's assets.	Failure to manage the liquidity required for the Fund's cashflows.	Requirement to divest investment assets at an unattractive time or missing investment opportunities which result in an adverse impact on the value of the Fund's assets	Ongoing	Capital & Investments Manager	Daily and weekly monitoring of Pension Fund's Cashflows; Currency Hedge requirements monitored ahead of cash requirements. *TREAT* Additional Actions Proposed: Improve quality of medium term cashflow forecasting for the Fund.	Partially Effective	3	3	9	Work plan and information requirements currently being developed in conjunction with other Employers. Work completed by Actuary for cashflow projections, to be presented to Committee/Board on 23rd March.

Pension Fund - Risk Register

							Controls		Residual Risk			Progress
No.	Category	Risk	Causes/Triggers	Consequences	Proximity	Risk Owner	Current Controls	Control Assessment	Impact	Likelihood	Score	Actions as at 23/03/2016
5.7	Administrative	Failure to keep pension records up to date and accurate resulting in failure to provide high quality pensions service to members and may lead incorrect pensions information being issued or incorrect benefits calculations or payments	Failure to keep pension records up to date and accurate	Incorrect records leading to incorrect estimates being issued and potentially incorrect pensions being paid.	Ongoing	HR Shared Services Manager	New pension administration system implemented; Resourcelink continued to be used for pension payments; Staffing structure of HR Shared Services continues to monitored to ensure adequate staffing and knowledge maintained; All HRSS staff fully trained in A to Z of Data Protection and fully compliant with SBC Data control requirements. *TREAT* Additional Action Proposed: Ensure communication plan put in place to ensure employees notify employers of any changes.	Partially Effective	2	3	6	Annual information sent to all members each August. Communication plan to further highlight to employees the importance of the requirement for accurate information.
5.8	Administrative	Failure to communicate effectively with stakeholders in Pension Fund resulting in inability to provide high quality pensions service	Failure to communicate effectively with stakeholders in Pension Fund	Scheme members not aware of their rights resulting in bad decisions; Employers not aware of regulations, procedures, etc.	Ongoing	HR Shared Services Manager/ Capital & Investments Manager	Engagement in Scottish pension networks; Union and Admitted body representation on the PFSC; Publication of annual report via website and printed copies to all Scheduled and Admitted bodies. *TREAT* Additional Action Proposed: Implementation of Communications Strategy.	Effective	2	3	6	Being developed in conjunction with Communication Team.
6.2	Regulatory & Compliance	Changes in legislation and other regulatory frameworks may impact adversely on the Fund in terms of funding levels, benefits and administrative and governance burdens.	Changes in legislation and other regulatory frameworks e.g. LGPS regulations, Pensions Regulator, HMRC	Loss of independence in the management of the Fund; Impact on Fund value and benefits; Increased costs to the Fund, employer contributions; Potential loss of active scheme members	Ongoing	Chief Financial Officer/ Chief Officer Human Resources	Participation in active CIPFA and Scottish Pension network allow changes and impacts to be identified quickly; Involvement with COSLA discussions on Pensions. *TREAT* Additional Action Proposed: Seek to input into any of the legislative change through active membership of COSLA.	Partially Effective	4	4	16	Responding to all consultations and participating in all national groups. Chief Financial Officer active member of Director of Finance group.
7.3	Reputation	Failure to appoint relevant advisers and review their performance may lead to inappropriate management of the Fund resulting from poor advice to decision makers	Failure to appoint relevant advisers and review their performance	Inappropriate management of the Fund resulting from poor advice to decision makers; Failure to achieve Pension Fund objectives. Legal challenge	Ongoing	Chief Financial Officer/Chief Officer Human Resources	Identify requirements of external advisers and appoint appropriately; Engagement of WM as independent performance monitoring for fund. *TOLERATE* Additional Action Required: Implement annual review of Adviser.	Effective	2	2	4	Reviewing current and ongoing requirements from all advisors to then undertake procurements where necessary and agree performance measures.
7.4	Reputation	Delays in implementation of decisions resulting in reducing the effectiveness of the decision and potentially adversely impacting on the ability to maximise investment returns	Delays in implementation of decisions	Reducing the effectiveness of the decision; Potentially adversely impacting on the ability to maximise investment returns; Loss incurred or reduced income received	Ongoing	Chief Financial Officer/Chief Officer Human Resources	Decisions minuted and appropriate staff assigned to implement; Agreed actions monitored by Democratic Services; Implementation timescales priorities according to risk levels and available resources levels. Business Plan 2015/16 - 2017/18 approved. *TREAT* Delivery of Business Plan to allow early identification and allocation of staff resources to actions.	Partially Effective	3	3	9	Business plan approved in June 2015 and being monitored.

CURRENCY HEDGE

Report by Chief Financial Officer

PENSION FUND COMMITTEE/PENSION FUND BOARD

23 March 2016

1 PURPOSE AND SUMMARY

1.1 **The purpose of this report is to update the Committee and Board on the current position of the Fund's currency hedging and review the short term position of the hedge.**

1.2 Aon Hewitt prepared a paper for the pension fund investment sub committee on the 2 February 2016 which recommended changes to the current 50% passive currency hedge against the dollar and the Euro with no change in the value of the hedge against the Yen.

1.3 The sub Committee accepted the recommendations in principle but asked that a further paper be brought back to pension Fund Committee following a further review by Aon and Council officers to determine the optimum hedging position following David Cameron's meeting in Brussels and the commencement of carrying on the Brexit referendum.

1.4 Recent movements in the value of sterling against the dollar and a review of how sterling is likely to perform in the foreseeable future indicates a reduction in the Fund's passive equity hedge to 25% against the US Dollar. The hedge ratio against the other overseas currencies, including the Euro and Yen, would remain at 50%.

1.3 The currency hedge results in a receipt or payment of cash on an actual basis. The latest quarter resulted in a payment of £8.3m from the Fund. Due to the liquidity position of the Fund the full value of the required payment was disinvested from the global equity portfolios. It is worth highlighting that due to currency movements the Fund's equities will have increased in value by c£16.6m over the quarter.

2 RECOMMENDATIONS

2.1 **It is recommended that the Pension Fund Committee:-**

(a) Note the current position of the currency Hedge

(b) Approve the reduction of hedging on the US Dollar from 50% to 25%

3 BACKGROUND

3.1 Investing in overseas equity markets introduces currency risk, in that returns may be increased or decreased depending on movements in currency markets. Consequently the volatility in currency market introduces an element of volatility into the investment returns when they are measured in sterling.

3.2 The currency hedge is part of the Pension funds risk management strategy. The hedge, managed by State Street Global Advisors covers 50% of all overseas currency exposure. The hedge was put in place in 2009 to protect the pension fund from extreme variations in the value of its oversees equity investments as the pound fluctuates in value against a range of major currencies including the US dollar, the Euro and the Japanese Yen. Overseas investments are valued in their country of origin and then converted to sterling. Variations in the value of sterling on foreign currency markets thereby has a material impact on the value of the Fund's overseas equity investments. The hedge protects the Fund from exposure to 50% of these variations whether they are positive or negative.

3.3 The Committee agreed in March 2012 to refine the mandate approach to implement half of the current 50% hedge on a passive approach and the other half on an active approach, so that overall the currency hedge ratio for a currency will be moved between 25% and 75% rather than always fixed at 50%. Work has been delayed due to the prioritisation of other activity including the setup of the new pension fund arrangements required in response to legislation changes which took effect from March 2015, the 2014 triennial valuation and the Investment consultancy mandate. While work on the currency hedge has commenced, with the development of an Investment Management Agreement, due to pressures of other procurements this has not yet gone to the market. The procurement is currently planned to commence upon completion of the live Investment Advisor and planned Custodian procurements.

3.4 The currency hedge requires the Fund to realise on a quarterly basis the value of the loss or gain as at quarter end. This results in either actual cash being received or paid from the Fund. The current cash position, excluding the currency hedge requirements, of the Fund is fairly neutral except when large retirements or transfers are required, with the monthly income from active members broadly in-line with the out goings to pensioners. The result of this is there is no cash balances held by the Fund to pay the currency hedge without requiring the Fund to disinvest from its investments.

4 CURRENT POSITION

4.1 The recent quarter has required the fund to pay in cash £8.3m. This has resulted in the full £8.3m being disinvested from the three Global Equity portfolios. It should be remembered however that this means the value of the Fund's oversees equity portfolio has increased by £16.6m before the cash hedge reduced this value by 50%.

4.2 A paper was prepared by Aon Hewitt and discussed at the Investment and Performance Sub Committee on 22 February (report attached as Appendix 1). It was agreed a report be refined and be presented to the Committee and Board for further discussion.

4.3 A telephone conference call has also been held, following the £8.3m cash requirement, between Officers and Aon Hewitt. Aon Hewitt believe there are a number of issues which need to be considered

- Aon Hewitt believe that there is now an increased risk of Brexit, but it is not their central outcome, placing a 30% chance on Brexit and a 70% chance of no Brexit.
- Brexit uncertainty has caused Sterling to weaken recently, and will increase Sterling volatility until the referendum, with Sterling expected to fall if the expectation of Brexit increases.
- Ignoring the impact of Brexit Aon do not expect much Sterling movement over the near term against the US Dollar as currently trading near fair value, but some further moderate appreciation of the US Dollar on economic grounds is expected and Aon expects the Euro to weaken in the short term
- If Brexit does happen would expect large drops in Sterling against the US Dollar (perhaps 10% to 15% from present levels) and smaller drop of Euro (perhaps 3% to 4% from present levels).
- The Brexit risks are greater relative to the Dollar because the Dollar is still the fundamentally stronger currency given the structural economic weakness of the Eurozone, which requires a prolonged period of ultra-easy monetary policy, and Brexit would be expected to weaken the EU as well.
- If Brexit does not happen then some moderate rebound of the recent weakening of Sterling against the Dollar in particular is expected which will offset any further appreciation of the Dollar relative to Sterling on economic grounds.
- Sterling has strengthened relative to the Yen recently brining some of the gains that had driven the previous recommendation to increase the hedge ratio to 60% so maintaining the hedge at 50% is now recommended.

4.4 Taking into account the Aon Hewitt's views on the future currency movements, the 30% probability of Brexit and the desirability of maintaining currency hedging as a form of risk mitigation, Officers and Aon Hewitt recommend changing the current hedging to the following

- Reduce hedging on US Dollar from 50% to 25%
- Maintain hedging on Euro at 50%
- Maintain hedging on all other currencies at 50%

This reduction should reduce the cash requirement fluctuations and still maintain an element of risk mitigation.

4.5 Officers and Aon Hewitt recommend the movement in Sterling is monitored regularly, at least monthly, by Officers and Aon Hewitt over the next few months until the active currency hedge manager is appointed.

5 IMPLICATIONS

5.1 Financial

(a) The fees for the current hedging average around £54k per annum. A reduction in the hedging would reduce the fees to around £36k. However the current contract with State Street Global has a minimum annual fee of £45k. This means the saving would be around £9k per annum.

(b) The reduction in the cash hedge against the dollar will reduce the need for the fund to sell its investments to pay for adverse movements the cash hedge on a quarterly basis,

5.2 Risk and Mitigations

(a) This is a complex area and hedging is designed to manage the risk of adverse currency fluctuations. Members have previously approved the appointment of an active currency manager to replace the current entirely passive arrangement. In which case it is acknowledged that maximising returns and minimising losses will be subject to the skill of the appointed currency hedge manager.

(b) It should be noted that an alternative strategy of completely removing any form of cash hedging and allowing the value of the overseas equity portfolio to fluctuate over time has been adopted by a number of the Scottish Funds managing the LGPS. This strategy introduces volatility into the value of pension fund investments and could increase risk at the triennial valuation but does recognise the very long term nature of pension fund investment.

5.3 Equalities

It is anticipated that there are no adverse impacts due to race, disability, gender, age, sexual orientation or religion/belief arising from the proposals in this report.

5.4 Acting Sustainably

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

5.5 Carbon Management

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

5.6 Rural Proofing

This section should only be completed if this is a new or amended policy or strategy.

5.7 Changes to Scheme of Administration or Scheme of Delegation

No changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report.

6 CONSULTATION

6.1 The Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk, the Chief Officer HR and the Clerk to the Council have been consulted and any comments received have been incorporated into the final report.

Approved by

David Robertson **Signature**
Chief Financial Officer

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Capital and Investment Manager, 01835 825249.

Background Papers:
Previous Minute Reference: Pension Fund Investment and Performance Sub Committee, 22 February 2016.

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Treasury & Capital Team can also give information on other language translations as well as providing additional copies.

Contact us at: Treasury & Capital Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825016 Fax 01835 825166. email: treasuryteam@scotborders.gov.uk

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Aon Hewitt
Consulting | Investment Consulting Practice

Scottish Borders Council Pension Fund
Date: 15 February 2016
Prepared for: The Officers
Prepared by: Kenneth Ettles

Hedging the foreign currency exposure within the Fund's equities

Introduction

This paper is addressed to the Officers of the Scottish Borders Council Pension Fund ("the Fund"), and reviews the Fund's overseas equities' currency hedging position.

The Fund currently hedges 50% of its overseas currency exposure within the equity portfolio, and this has been in place since 1 July 2009. The Pension Fund Committee currently hedges passively, ie the appointed currency hedging manager hedges 50% of each overseas currency exposure, and does not try to add any additional value by adjusting the hedge ratio above or below 50% based on their views on future currency movements. However, the Fund is expected to procure an active currency hedging manager later this year to make these adjustments.

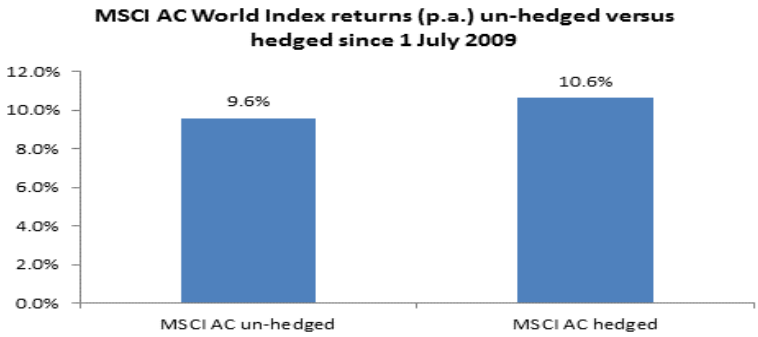
In the meantime the Officers have asked if the Fund should consider making any medium term changes to the current 50% hedge ratio based on Aon Hewitt's views. In particular, Officers asked for Aon Hewitt's views on whether the currency hedge should be removed i.e. the hedge ratios all reduced to 0%.

Background

The Fund started hedging 50% of its equities' overseas currency exposure on 1 July 2009. This followed a review of the Fund's equity portfolio which resulted in a reduction in the UK equity allocation, and an increase in the non UK equity allocation. To avoid a significant increase in currency risk from this change, it was agreed that 50% of equities' overseas currency risk should be hedged.

In the next chart we compare the performance of the MSCI AC World Index, hedged versus un-hedged, from 1 July 2009 to 31 December 2015.

We can note that the hedged index has outperformed the un-hedged version meaning pension schemes that were passively invested in global equities would have experienced a better return if their currency exposure had been hedged. A 50% hedged passive portfolio would have returned 10.1% p.a.



However, as the Fund's global equity managers manage active mandates where they try to outperform the benchmark, they will therefore have different regional and currency exposures relative to the benchmark which will impact the effect of the currency hedging position. In particular the Fund has had more exposure to the US Dollar than the index allocation, over a period when the US Dollar has strengthened by around 12% relative to sterling.

For the Fund it is therefore perhaps more meaningful to consider the total net payments made from the Fund on the currency hedging contracts over this period. The table below summarises the payments made on the currency hedging contracts on an annual basis since it was implemented.

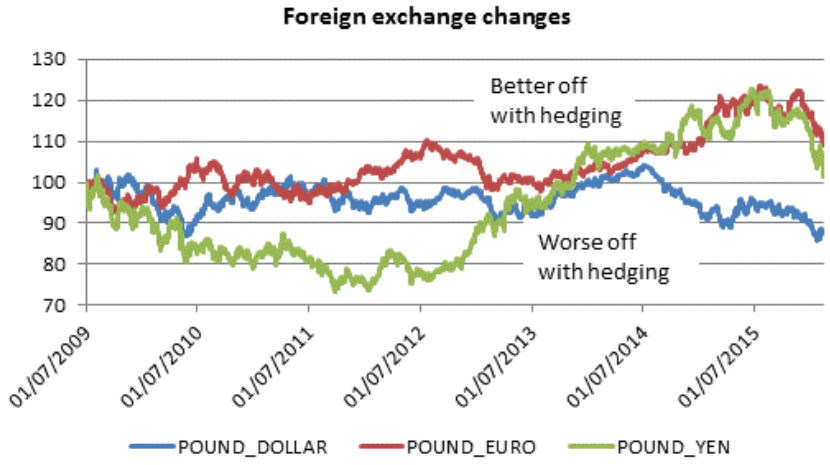
We can note that the total cumulative payment has been approximately £3.2m, which indicates the Fund's unhedged part of the Fund's equities has marginally outperformed the hedged part of the Fund's equities. This cumulative payment is small in the context of the Fund's cumulative equity market exposure of c £1,000m over the 7 year period.

Year	Return from currency hedging (£'m)
2009	(£2.7)
2010	(£2.9)
2011	(£2.2)
2012	£3.7
2013	£2.2
2014	(£0.8)
2015	(£0.5)
Total	(£3.2)

Over this period there have been some strong swings in the value of sterling. As we can note from the next chart sterling has weakened over the last 18 months relative to the US Dollar, and over the last 3 months

versus the Yen and Euro.

Hence, with hindsight the Fund value would be higher at the end of 2015 if the US Dollar position had been reduced (or removed) 18 months ago, and the same for the Yen and Euro position 3 months ago. Those are the types of trades that the active currency manager, once appointed, will look to anticipate, and implement, in order to improve the outcome for the Fund.



Aon Hewitt's forward looking views

Recent UK economic softness, the large external deficit and Brexit nerves are weakening sterling. Our view is that sterling will remain vulnerable and further downward pressure should continue given the uncertainty around the EU referendum and that expected increase in interest rates, which only a few months ago were expected to happen in 2016, have been pushed back further. However, although there are expected to be these downward pressures on sterling, there are also factors affecting other currencies we need to consider when considering the hedge ratio.

The US Dollar has strengthened over the past 18 months on the back of stronger growth in the US relative to other regions and tighter monetary policy - the Federal Reserve raised the US base rate in December 2015. However, the period of general US Dollar strength seems to have come to an end recently. As strains in the global economy have come to the fore this quarter, it has become more apparent that interest rates will remain low globally, including in the US. Expected policy rate increases have been pushed back in both the US and UK, but we think that the UK will be more reticent to hike rates, given political risks and the fact that the UK economic recovery will be hindered as investment plans are delayed against the background of this political uncertainty. On balance we expect some continued strengthening of the US Dollar relative to sterling. We therefore would recommend that some of the hedging of the US Dollar is removed and the hedge ratio reduced below 50%.

Further Eurozone monetary easing has become more likely but our view is that this will not necessarily significantly weaken the Euro against sterling, and on balance be offset by the reasons noted two paragraphs above.

We see the potential for further Japanese easing bringing the risk that the yen will give back more of its recent strengthening. We also think that Japan is more likely to surprise the market with an initiative to stimulate the economy and weaken the yen than in the Eurozone given the need to break Japan's deflationary trend.

We therefore would suggest some of the hedging of the Euro is removed and the hedge ratio reduced below 50%, but to increases the protection against the risk of yen depreciating relative sterling by increasing the hedge ratio above 50%.

Given their disparate nature we do not form views on individual emerging market currencies. Generally, over the medium term to long term, we expect emerging market currencies to appreciate as their economies continue to develop. This would be supportive of having a nil or low currency hedge ratio for their emerging market equities exposure over the long term. However, within emerging market currencies we do expect lots of short-term volatility especially from China, which could weaken emerging markets currencies, so emerging market currency appreciation may not happen straight away. Given this potential for short term volatility we would recommend retaining the hedge ratio at 50% for the present and review in say 6 months' time.

Recommendation

We recommend the Fund does not take a generic approach and remove the currency hedges as this would significantly increase risk and we would recommend the exposures to individual currencies are considered independently.

Our recommendations relate to the Fund's sterling exposure versus the US Dollar, Yen and Euro which accounts for around 80% of the Fund's non UK equity exposure and currency hedging positions (see Appendix).

We have also noted the exposures to the remaining currencies although for those countries, such as Brazil or the Swiss franc, we do not have a specific view on the individual currencies, and hence recommend the continuation of the 50% hedge ratio.

We recommend that from a **long term** risk management perspective the Fund retains a strategic long term base hedge ratio of 50% of its developed market overseas currency exposures, and periodically consider the base hedge ratio for emerging market overseas currency exposures.

However, given recent market moves, and Aon Hewitt's current medium term outlook for sterling, if the Officers and Pension Fund Committee

wish to adjust the currency hedge ratio in advance of an active currency hedging manager being appointed, we would recommend the following adjustments :

- Reduce the hedging position versus US Dollar from 50% to 40%
- Reduce the hedging position versus Euro from 50% to 40%
- Increase the hedging position versus Yen from 50% to 60%

As noted earlier, the US Dollar, Euro and Yen represent around 80% of the Fund's overseas equities' currency exposure. The remaining 20% exposure is primarily the Swiss franc (around 10%), developed Asia (Hong Kong Dollar and Australian Dollar) and emerging market currencies. As Aon Hewitt do not form individual views on these currencies we recommend retaining the 50% hedge ratio.

Appendix

Summary

The table below summaries the Fund's overseas currency exposure as at 30 September 2015.

Currency	Overseas Equities Value at 30/09/15	%
AUD	£849,335	0.4%
CHF	£23,220,848	11.2%
EUR	£28,568,581	13.8%
HKD	£2,446,823	1.2%
JPY	£12,471,527	6.0%
SEK	£3,349,868	1.6%
USD	£125,708,537	60.9%
BRL	£409,095	0.2%
CAD	£1,109,933	0.5%
DKK	£896,012	0.4%
IDR	£0	0.0%
KRW	£2,395,153	1.2%
NOK	£1,425,938	0.7%
SGD	£0	0.0%
ZAR	£3,620,913	1.8%
Total for hedged currencies	**£206,472,563**	**100.0%**

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REVIEW OF ADDITIONAL VOLUNTARY CONTRIBUTION ARRANGEMENTS

Report by Chief Officer Human Resources

JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION BOARD

23 March 2016

1 PURPOSE AND SUMMARY

1.1 **This report seeks approval from the Joint Pension Fund Committee and Board to commence a review of the AVC provision of the Fund.**

1.2 The current provider has been used since 2002 when the last review was carried out, due to issues being experienced with the provider, including the lack of promotion of the AVC option. It is an opportune time to commence a review of the provision.

2 RECOMMENDATIONS

2.1 **It is recommended that the Pension Fund Committee and Pension Board:-**

(a) Approves the commencement of a review of the AVC provision in consultation with procurement.

(b) Notes that a further update will be provided to the Joint Committee and Board before proceeding.

3 BACKGROUND

3.1 Additional Voluntary Contributions (AVC's) were introduced in the mid 1980s as an additional means for individuals to save for retirement. AVC's offered an attractive, tax advantageous, savings mechanism which was relatively unique at that time. It is a requirement (under the Social Security Act of 1986) for every UK pension scheme to have an arrangement in place whereby members can pay additional voluntary contributions to enhance their pension benefits.

3.2 An active member of the Local Government Pension Scheme (LGPS) may elect to pay AVC's into a scheme established under an arrangement made between the administering authority and a body approved for the purposes of the Finance Act 2004. An employer may contribute to the AVC scheme and where they do the AVC scheme is known as a shared cost additional voluntary contributions arrangement and contributions to it as "SCAVCs". As direct costs would be incurred by Scottish Borders Council, the policy of Scottish Borders Council was not to adopt this discretion.

3.3 Historically (since 1989) the Council had two AVC providers, Halifax PLC and Standard Life. Following its acquisition of Clerical Medical, Halifax PLC carried out a review of various activities associated with long-term savings products. One of the outcomes of the review was that Halifax ceased to operate its AVC Deposit Account product from 30 June 2002. All members with Halifax accounts were compulsory transferred to Standard Life on 1 July 2002.

3.4 AVC arrangements were lasted reviewed in 2002. In a report commissioned at the time of Halifax withdrawing from AVC provision, our actuaries at the time Hymans Robertson, stated:

"Given all of the other (investment) opportunities available, Schemes should not feel constrained to offer a wide choice of AVC provider or fund options, or the need to replace Halifax with another Cash Deposit provider".

This resulted in the Pension Fund including a cash deposit fund (Sterling Fund) within the range of funds agreed with Standard Life.

3.5 Standard Life allows investment in an agreed range of funds at the selection of the employee. An optional death-in-service (only) life assurance facility was previously available however this service has since been discontinued for new business. The present "limited" range of funds agreed with Standard Life are:

a) Deposit & Treasury Pension Fund (formerly called the "Managed Cash Fund")

b) Ethical Fund

c) Managed One Fund

d) Money Market Pension Fund (formerly called the "Sterling Fund")

e) Protection One Fund

f) UK Equity One Fund

g) With Profits Fund

The minimum investment period for the above funds is 12 months (for monthly Payments).

3.6 Standard Life no longer provide formal financial advice to employees on the above range of funds. Members select funds at their own discretion (and risk). Standard Life provide an Annual Statement, sent directly to members (both active and deferred) who participate in AVC arrangements.

3.7 At 31 March 2015 the fund comprised of 125 members (both active and deferred), with a total fund value of £833,040.

3.8 For some time now, we have experienced issues with the service provided by Standard Life. These issues include:

a) Lack of documentation for members.

b) No active promotion of the AVC facility by Standard Life (staff workshops?).

c) Returned payments - resulting from poor administrative practices by Standard Life.

d) No dedicated customer service/relationship manager for account.

4 PROPOSAL

4.1 In light of the issues currently being experienced with the current provider it is proposed that we commence a review of the AVC provision for the Pension Fund.

4.2 It may be impractical to entirely discontinue the Council's arrangement with Standard Life, as some existing member funds (particularly "with profits") may suffer a financial penalty for enforced transfer, for which members may reasonably hold the Administering Authority responsible.

4.3 In order to inform this review it is proposed that a discussion be held with the procurement team to identify any available frameworks and a report be presented back to the joint meeting of the Pension Fund and Board

5 IMPLICATIONS

5.1 Financial

There are no direct financial implications of this report.

5.2 Risk and Mitigations

The risk management framework for the Pension Fund and any subsequent procurement discussion is designed to mitigate or tolerate these risks.

5.3 Equalities

It is anticipated that there are no adverse impacts due to race, disability, age, sexual orientation or religion/belief arising from the proposals in this report.

5.4 Acting Sustainably

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

5.5 Carbon Management

There are no direct carbon emission impacts as a result of this report.

5.6 Rural Proofing

It is anticipated that there will be no adverse impact on the rural area from the proposals contained in this report.

5.7 **Changes to Scheme of Administration or Scheme of Delegation**

No changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report.

6 CONSULTATION

6.1 The Chief Financial Officer, the Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk and the Clerk to the Council have been consulted and any comments received have been incorporated into the final report.

Approved by

Clair Hepburn **Signature .....**
Chief Officer Human Resources

Author(s)

Name	Designation and Contact Number
Ian Angus	HR Shared Services Manager, 01835 826696

Background Papers: None
Previous Minute Reference: None

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PROPOSED ADMISSION TO THE LOCAL GOVERNMENT PENSION SCHEME

Report by Chief Officer Human Resources

JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION BOARD

23 March 2016

1 PURPOSE AND SUMMARY

1.1 **This report seeks approval for the amendment of the admission agreement for Borders Sport and Leisure Trust into the Local Government Pension Scheme to incorporate those members transferring from Cultural Services.**

1.2 The current provision of Cultural Services by the Council is scheduled to transfer to Borders Sport and Leisure Trust on 1 April 2016. The Council agreed as part of the business case approved on 7 October 2015 that staff who are currently members of the Council's Pension Scheme will remain members following the integration of the Cultural Services and Borders Sport and Leisure Trust would apply for amendment to the admission agreement.

1.3 The admission agreement needs to be updated to reflect Borders Sport and Leisure Trusts eligibility criteria for future members, where employees must have completed five years' service before they are offered membership to the Local Government Pension Scheme. This eligibility criteria will also be applied to those employees transferring who are not currently members of the Scheme and any future new employees of the Integrated Trust.

1.4 A report is being presented to Council on 31 March 2016 seeking approval that the Council will underwrite the risk of Borders Sport and Leisure Trusts membership of the Pension Fund should the company cease to trade.

1.5 It should be noted that Borders Sport and Leisure Trust under the terms of the service provision agreement is precluded from varying the terms of the admission agreement without the approval of Council and the Pension Fund.

2 RECOMMENDATIONS

2.1 **It is recommended that the Pension Fund Committee and Pension Board:-**

(a) **Agree to enter into an appropriate agreement with Borders Sport and Leisure Trust to amend the admission agreement to admit the Integrated Trust to membership of the pension fund on terms and conditions to the satisfaction of the Chief Executive and Chief Financial Officer.**

(b) **Note that a report will be presented to Council on 31 March 2016 seeking agreement that the Council will act as guarantor in the event that the Integrated Trust ceases to operate in future.**

3 BACKGROUND

3.1 In terms of the Local Government Pension Scheme (Scotland) Regulations 2014 the Council, as administering authority of the Scottish Borders Pension Fund, may on such terms and conditions as they think proper, admit employees of bodies that satisfy the statutory criteria to participate in benefits of the Pension Fund.

3.2 Any admitted body must also satisfy HM Revenue and Customs requirement that it is associated with at least one of the employers already in the Pension Fund. This is normally achieved by establishing a permanent community of interest or interdependence with another employer or where 50% of the employer's funding comes from local authorities.

3.3 Borders Sport and Leisure Trust (BSLT) has been a member of the Scottish Borders Pension Fund since 2003 and is seeking to amend the admission agreement to include those employees who are currently scheme members in the Cultural Services section of the Council who will be transferring to BSLT on 1 April 2016.

3.4 A number of years ago BSLT amended their eligibility criteria for membership of the Scottish Borders Pension Fund, where an employee must have completed five years' service before they are offered membership of the scheme. The eligibility criteria will apply to those employees who transfer and are not currently members of the scheme and any future employees. The amended admission agreement must also reflect this change.

4 THE INTEGRATED TRUST

4.1 BSLT, formed in 2003, will become an Integrated Trust with the transfer of Cultural Services within the Scottish Borders. There are approximately 150 staff currently employed by Scottish Borders Council and members of the Local Government Pension Scheme who will be transfer to the integrated trust on 1 April 2016 and who will be covered by the admission agreement.

4.2 The Pension Fund's Actuary, Barnett Waddingham, has determined an appropriate employer's contribution rate, 18%, taking account of the age profile and service of the staff involved and whether or not there would require to be a guarantor in the event of BSLT ceasing. The contribution rate agreed from 1 April 2016 will apply until the next triennial valuation of the Fund in 2017 at which time it will be subject to the same review as other employer rates as part of the actuarial valuation process.

4.3 The amended admission of BSLT would require that the Council underwrite the premature termination risk should the Trust cease to operate. A report will be presented to Council on 31 March 2016 seeking this agreement.

4.4 No changes can be made to the status of the Fund, pension benefit for employees or employer contribution without the written agreement of the Council and Pension Fund.

5 IMPLICATIONS

5.1 Financial

The Actuary has estimated that the potential liability in relation to premature risk is £2.937m at current valuation assumptions. A paper is being presented to Council on 31 March 2016 to seek agreement to underwrite this risk in the event of premature termination.

5.2 Risk and Mitigations

If Borders Sport and Leisure Trust were to cease trading and prematurely terminate its admission agreement the responsibility for continuing service provision and the liabilities of the Trust will revert back to the Council responsibility and therefore the Council would still be exposed to the same level of risk minimising the risk to the Pension Fund. A paper is being presented to Council on 31 March 2016 to seek agreement to underwrite this risk in the event of premature termination.

5.3 Equalities

It is anticipated that there are no adverse impacts due to race, disability, age, sexual orientation or religion/belief arising from the proposals in this report. Continued membership of the Local Government Pension Scheme ensured that employees are not disadvantaged.

5.4 Acting Sustainably

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

5.5 Carbon Management

There are no direct carbon emission impacts as a result of this report.

5.6 Rural Proofing

It is anticipated that there will be no adverse impact on the rural area from the proposals contained in this report.

5.7 Changes to Scheme of Administration or Scheme of Delegation

No changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report.

6 CONSULTATION

6.1 The Chief Financial Officer, the Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk and the Clerk to the Council have been consulted and any comments received have been incorporated into the final report.

Approved by

Clair Hepburn **Signature .....**
Chief Officer Human Resources

Author(s)

Name	Designation and Contact Number
Ian Angus	HR Shared Services Manager, 01835 826696

Background Papers: None
Previous Minute Reference: None

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LGPS POOLED INVESTMENT & INFRASTRUCTURE

Briefing paper by Chief Financial Officer

PENSION FUND COMMITTEE AND PENSION FUND BOARD

23RD March 2016

1 PURPOSE AND SUMMARY

1.1 **The purpose of this briefing paper is to provide the Committee and Board with an update on the LGPS Pooled Investment work currently underway in England and Wales.**

2 ENGLAND AND WALES POSITION

2.1 Following an announcement by George Osborne in October 2015 and a consultation by Department of Communities and Local Government smaller LGPS funds across England and Wales have been encouraged to look at pooling their investments in a drive to increase efficiencies and increase investment in infrastructure.

2.2 The key drivers to the pooling of funds were as follows

- Efficiencies in Investment Manager Fees due to increase scale.
- Pools of scale to ensure investment expertise developed and available.
- Improve capacity to invest infrastructure projects.

2.3 The 89 administering authorities were to work together to come up with proposals for pools of at least £25bn. Initial proposals were to be submitted to Government by 19th February 2016 followed by more detailed proposals by 15th July 2016. All proposals were to include the following elements

- The size of the pool once fully operational
- Any assets they propose to hold outside the pool and rational for doing so
- Type of pool, including legal structure if relevant
- How pool will operate, work to be carried out internally and services to be hired from outside
- Timetable for establishing the pool and moving assets into pool

2.4 Initial proposals have been submitted from various pools and further work is ongoing to look at Governance, costs involved in transferring assets and possible savings to be generated by the pools. Implementation and transfer of funds is expected to start in April 2018.

3 SCOTTISH POSITION

3.1 The current review does not directly affect the Scottish LGPS funds but the Scheme Advisory Board for Scotland is being briefed on a regular basis.

3.2 The recommendations for the recent Scottish Parliament Local Government and Regeneration Committee inquiry is shown below.

Pooling of pension funds

44. The UK Chancellor recently announced 89 LGPS in England and Wales[36] are to be pooled into six British Wealth Funds to enable them to invest more in infrastructure and to minimise fees and costs. We also note the potential for the second Markets in Financial Instruments Directive to restrict smaller pension funds ability to invest in infrastructure. We would find it helpful to know what discussions the Scottish Government has had with the UK Government to safeguard opportunities for smaller Scottish pension funds to invest in infrastructure.

45. We agree investment in infrastructure is vital to a successful economy, but we are less attracted to the UK's formal pooling arrangements for Scottish pension funds. During our inquiry we heard how informal collaborations worked well because there was a willingness to work together for a shared vision and benefit. Strathclyde, Falkirk and Lothian and a few others are already working with other funds to increase their investment options. This is to be applauded and we encourage funds to seek out opportunities to work collaboratively to benefit from shared expertise in identifying suitable infrastructure investment and to reduce investment costs such as management fees. Being proactive in this regard has particular importance given the potential changes to investment rules.

4 NEXT STEPS

4.1 Officers will continue to monitor the English and Welsh position and further briefings will be presented to the Committee and Board.

4.2 Officers will continue to seek to identify opportunities for Infrastructure investment opportunities and partnership working opportunities with other Scottish LGPS Funds.

Approved by

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March 2016

BULLETIN

The Pensions Regulator
The Board received a presentation from staff of The Pensions Regulator at the February meeting. They set out the role of the regulator and the range of resources available for pension board members and others. They also outlined the findings of the regulator's recent survey of progress on governance and administration. Further information is available on their website.

SAB Work Plan
The Deputy First Minister has approved the SAB work plan.

The first data collection exercise has been completed and a summary will be published in the Annual Report later this year. In the morning awareness session, the Board received a presentation from Dr Chris Sier on pension data, with a focus on transparency of investment costs. There are UK wide developments on this issue that the Board will follow with interest. The data will also feed into the Board's review of the structure of SLGPS funds.

The Board also noted developments in England and Wales on pooling of investments and the recommendations of the Scottish Parliament Local Government and Regeneration Committee inquiry on pension fund investments. While the committee was less attracted to the formal pooling arrangements in England and Wales, they did recommend that funds work collaboratively to identify infrastructure investment.

A related issue also highlighted by the Local Government Committee is fiduciary duty. The Board noted a legal opinion on this issue it had commissioned from Pinsent Masons. The Board will consider guidance to funds at its next meeting.

Cessation Valuations
The SPPA has conducted a data collection exercise in relation to existing and potential cessation valuations. This gives a broad indication of the extent of the risks. The Board agreed that there was enough information to proceed with guidance to funds and that will be drafted for consideration at the next meeting.

Review of Regulations
The Board welcomed the very speedy amendment to the regulations that will allow funds to increase investment in infrastructure. This is an interim solution and the Board remains committed to a more substantial review of the investment regulations that gives funds greater investment flexibility.

There will be further discussions through the Joint secretaries on early retirement and pensionable pay regulation proposals.

SAB Website
It was agreed that the Board will develop a website to improve communications with stakeholders.

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