Public Document Pack

PENSION FUND COMMITTEE AND PENSION BOARD
THURSDAY, 13 SEPTEMBER 2018

A MEETING of the PENSION FUND COMMITTEE AND PENSION BOARD will be held in the

COUNCIL CHAMBER, COUNCIL HEADQUARTERS, NEWTOWN ST BOSWELLS on

THURSDAY, 13 SEPTEMBER 2018 at 10.00 AM

J. J. WILKINSON,
Clerk to the Council,

6 September 2018

BUSINESS		
1.	**Apologies for Absence**	
2.	**Order of Business**	
3.	**Declarations of Interest**	
4.	**Minute** (Pages 3 - 10) Minute of Meeting held on 14 June 2018 to be noted and signed by the Chairman. (Copy attached).	2 mins
5.	**Pension Fund Investment Performance Sub-Committee** (Pages 11 - 12) To note the Minute of the Pension Fund Investment Performance Sub-Committee held on 22 August 2018.	2 mins
6.	**Budget Monitoring** (Pages 13 - 16) Consider report by Chief Financial Officer. (Copy attached).	5 mins
7.	**Risk Register Update** (Pages 17 - 24) Consider report by Chief Financial Officer. (Copy attached).	10 mins
8.	**Pension Administration Strategy** (Pages 25 - 46) Consider report by Chief Officer Human Resources. (Copy attached).	5 mins
9.	**LGPS Structure Consultation** (Pages 47 - 82) Discussion. (Information papers attached)	45 mins
10.	**Strategic Investment Review** (Pages 83 - 122)	30 mins

	Consider report by Chief Financial Officer (Copy attached).	
11.	**Information Update** (Pages 123 - 126) Consider briefing paper by Chief Financial Officer. (Copy attached)	15 mins
12.	**Statement of Responsible Investment/ESG Policy** (Pages 127 - 132) Consider report by Chief Financial Officer. (Copy attached),	20 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 133 - 134) Private Section of Minute of Meeting held on 14 June 2018 to be noted and signed by the Chairman. (Copy attached).	2 mins
17.	**Pension Fund Investment Performance Sub-Committee** (Pages 135 - 140) To note the private minute of the Pension Fund Investment Performance Sub-Committee held on 22 August 2018. (Copy attached).	2 mins
18.	**Quarter Performance Update** (Pages 141 - 194) Consider report by KPMG. (Copy attached).	35 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 D. Parker (Chairman), J. Brown, G. Edgar, D. Moffat, S. Mountford, S. Scott, S. Aitchison, Mr E Barclay, Mr M Drysdale, Ms K M Hughes, Ms L Ross, Mr P Smith, Ms C Stewart and Mr J Terras

---

Please direct any enquiries to Judith Turnbull Tel No. 01835 826556
Email: Judith.Turnbull@scotborders.gov.uk

SCOTTISH BORDERS COUNCIL
PENSION FUND COMMITTEE AND PENSION BOARD

MINUTES of Meeting of the PENSION FUND COMMITTEE AND PENSION BOARD held in Committee Rooms 2 and 3, Council Headquarters, Newtown St Boswells on Thursday, 14 June 2018 at 10.00 am

_____

Present:-	Councillors S Mountford (Chairman), J. Brown, G. Edgar, S. Scott, S. Aitchison, Mr E Barclay, Mr M Drysdale, Ms L Ross, Ms C Stewart.
Apologies:-	Councillors D Parker, J Fullarton, D Moffat, Ms K M Hughes, Mr J Terras, Mr P Smith.
In Attendance:-	Chief Financial Officer, Pension and Investment Manager, HR Shared Services Manager, (Para 8) Mr D O'Hara (KPMG), Mr Singh (KPMG), Democratic Services Officer (J Turnbull).

1. **WELCOME**

The Chairman welcomed those present to the meeting and advised that Mr Campbell Hogarth, Unison representative on the Pension Board, had resigned and had been replaced by Mr Jim Terras. On behalf of the joint Committee and Board, the Chairman thanked Mr Hogarth for his valuable contribution to the Pension Fund Committee, Pension Board and Pension Fund Investment Performance Sub-Committee.

DECISION
NOTED the resignation of Mr Campbell Hogarth and the appointment of Mr Jim Terras as Unison representative on the Pension Board.

2. **MINUTE**

There had been circulated copies of the Minute of the Meeting of 8 March 2018.

DECISION
NOTED for signature by the Chairman.

3. **PENSION FUND INVESTMENT PERFORMANCE SUB-COMMITTEE**

There had been circulated copies of the Minute of the Pension Fund Investment and Performance Sub-Committee dated 26 February 2018.

DECISION
NOTED the Minute.

4. **TRIENNIAL VALUATION AS AT 31 MARCH 2017**

There had been circulated copies of a report by the Chief Financial Officer, detailing the outcome of the triennial valuation of the Scottish Borders Council Pension Fund as at the 31 March 2017 and proposing the employer contribution rates for the next three years. The full Valuation Report, prepared by the Fund actuary Barnett Waddingham, was contained in Appendix A to the report. The report concluded that the Scottish Borders Council Pension Fund had a funding level of 114% compared to the previous 2014 valuation of 101%. This equated to a funding surplus of £80.6m. The revised "Primary rate" calculated had increased from 18% to 20.6%. However, to allow employer contributions to remain stable the Actuary recommended the surplus be utilised over a 53 year period. This would allow the "Pool" rate to remain at 18% of payroll for most employers who participated in the scheme on an open basis. It was noted that Scottish Borders Housing Association (SBHA) and CGI were both operating as closed funds with new employees unable to join the Fund. Due to the increased risk with these employers,

individual rates were recommended by the Actuary. The recommended rates from 1st April 2018 for these were 20.3% for SBHA and 19.8% for CGI. In response to a question, Mr O'Hara, Investment Advisor, KPMG, advised that relative to other Scottish Funds the Scottish Borders Pension Fund was performing well and with the changes to the Investment Strategy, this was expected to continue.

DECISION
AGREED the Fund Valuation Report as at 31 March 2017 as set out in Appendix A to the report and the resulting employer contributions rates proposed and applied from 1 April 2018.

5. **FUND STRATEGY STATEMENT 2018**

There had been circulated copies of a report by the Chief Financial Officer proposing the revised Funding Strategy Statement (FSS) for 2018. The report explained that the Pension Fund was required by the Local Government Pension Scheme (LGPS) Regulations to have an up to date FSS, attached as Appendix A to the report, which should be kept under review and updated and approved annually. A full review of the FSS had been undertaken following the 2017 valuation to reflect changes to recent guidance. The Local Government Pension Scheme (LGPS) regulations and guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA) recommended the FSS be consulted on with all participating employers and members. All participating employers had been circulated with the draft FSS and it had been made available to members via the Scottish Borders Pension Fund website. Ms Robb, Pension and Investment Manager, highlighted that the FSS had been updated to reflect that LIVE Borders had moved back into the main pool and that CGI was now a closed Fund.

DECISION
AGREED the Funding Strategy Statement set out in Appendix A to the report.

6. **SCOTTISH BORDERS COUNCIL PENSION FUND INTERNAL AUDIT ANNUAL ASSURANCE REPORT 2017/18**

There had been circulated copies of a report by the Chief Officer Audit & Risk presenting the Internal Audit Annual Assurance Report for the year to 31 March 2018. The Report included the Chief Officer Audit & Risk's independent assurance opinion on the adequacy of the Scottish Borders Council Pension Fund's overall control environment. The report explained that that Public Sector Internal Audit Standards (PSIAS) required that the Chief Officer Audit & Risk provided an annual internal audit opinion and report on the adequacy and effectiveness of the Pension Fund's governance, risk management and internal controls to support the preparation of the Pension Fund's Annual Governance Statement. To meet the requirements of the PSIAS the Scottish Borders Council Pension Fund Internal Audit Annual Assurance Report 2017/18 included the Internal Audit annual opinion, provided details of Internal Audit activity during the year to support the opinion, and stated the conformance of the Internal Audit service with the PSIAS. The Chief Officer Audit & Risk's opinion was that, based on Internal Audit reviews and knowledge, the systems of internal control within the Scottish Borders Council Pension Fund were operating satisfactorily, and governance and risk management arrangements were effective with evidence of improvement during the year. The independent assurance opinion had been used to inform the Pension Fund's Annual Governance Statement 2017/18. In response to questions, Mr Robertson acknowledged that implementation of Business World had been challenging and a number of modifications had been made to the system. He confirmed that the Council would only be charged for enhancements to the system, not any rectifications which had been required. Members noted that Business World would be fully operational by September 2018.

DECISION
NOTED the Scottish Borders Council Pension Fund Internal Audit Annual Assurance Report 2017/18.

7. **GOVERNANCE POLICY & COMPLIANCE STATEMENT 2018**

There had been circulated copies of a report by the Chief Financial Officer which proposed the revised Governance Policy and Compliance Statement for the Scottish Borders Council Pension Fund (the Pension Fund) following implementation of the 2015 regulatory changes. The report also requested approval of the revised Governance Compliance Statement, included in Appendix B to the report, for inclusion in the Pension Fund's Annual Report and Accounts 2017/18. The Governance Compliance Statement, included in Appendix 1 to the Policy, demonstrated that the Pension Fund was in full compliance with best practice guidance. Mr Robertson highlighted that the Pension Fund now had a standalone website which detailed governance arrangements and Fund information. An interactive site was proposed for 2020/21 which would allow for pension quotations to be provided. Members requested that as the interactive site would assist the workload of the Pension Team, an earlier implementation date should be considered. In response to a question regarding SB Supports LLP, Mr Robertson clarified that limited liability partnerships had been set up to establish partnership working with the Council and that SB Supports LLP held a small number of administration personnel.

DECISION

AGREED the revised Governance Policy and Compliance Statement 2018 and the Governance Compliance Statement for inclusion in the Pension Fund Annual Report and Accounts 2017/18.

8. **PENSION ADMINISTRATION PERFORMANCE 2017/18**

There had been circulated copies of a report by the Chief Officer Human Resources presenting the Pension Administration Performance 2017/18 and requesting the Committee's approval for its inclusion in the Annual Report for the Fund. Appendix 1 to the report contained the Pension Administration Performance for 2017/18 as it would be included in the Fund's Annual Report and Accounts. The report explained that during 2017/18 there had been an improvement in payments, to the extent that all were received on time. However, performance had not been at the same high standard as in previously reported years, this has been due to the replacement of the long standing payroll system within Scottish Borders Council, the retiral of two members of the Pensions Team and a period of long term absence at a key point in the year. The Annual Benefit Statements had been issued seven days later than required and this had been reported to the Pensions Regulator who confirmed that there was no further action to be taken by them due to the clear rectification plan that was in place. The report advised that there had been another successful Employer Liaison Meeting held during 2017/18 and that this event would be held on an annual basis. In response to questions Mr Angus, HR Shared Services Manager, advised that there were no instances where payments had been late and that from February 2018, Annual Benefit Statement queries were answered within the required 20 day target period. Mr Angus also advised that discussion on a self-service enhancement to the website had commenced and the joint Committee and Board would be updated on progress.

DECISION

(a) NOTED the Pension Administration Performance for 2017/18 as set out in Appendix 1, to the report.

(b) AGREED the inclusion of the Pension Administration Performance for 2017/18 in the Pension Fund Annual Report and Accounts 2017/18.

9. **TRAINING PLAN 2018/19**

There had been circulated copies of a report by the Chief Financial Officer comparing the actual 2017/18 attendance for Pension Fund Committee and Pension Board Members to the requirements detailed in the current Training Policy approved in June 2017. In line with this Policy, the Pension Fund agreed to undertake an annual Knowledge and Skills Self-Assessment to identify key areas for the future year's training plan and the report proposed key areas of training for 2018/19. The Training Knowledge and Skills

Assessments had identified key areas of training including: the role of the Custodian, LGPS Benefit structure, understanding of the regulatory environment, knowledge of financial markets and investment products. Members were strongly encouraged to actively participate in all training events to demonstrate their commitment to enhancing the governance of the Pension Fund and to support effective decision making. In response to a question regarding completion of the Trustee Toolkit, Ms Robb advised that this was mandatory and required to be completed within six months of joining the Committee or Board. With regard to any sanctions that could be imposed on members who did not attend training events or the required number of Committee meetings, Ms Robb explained that it was for the joint Committee and Board to decide what sanctions, if any, to impose. Following discussion, the joint Committee and Board asked that the Chairman write to all Pension Fund Committee and Pension Board members reminding them of their responsibility to attend meetings and to undertake training as required.

DECISION

(a) NOTED:

(i) The Training Policy in Appendix 1 to the report;

(ii) The outcome of the 2017/18 training programme and the attendance levels for training and meetings; and

(iii) The outcome of the Knowledge and Skills Self-Assessment for 2018/19.

(b) AGREED:

(i) The training areas for 2018/19 set out in paragraph 6.2 of the report and that all members should prioritise attendance at training events whenever practicable; and

(ii) To request that the Chairman write to all members of the Pension Fund Committee and Pension Board reminding them of their responsibility to attend meetings and undertake training as required.

10. **BUSINESS PLAN 2018/19 TO 2020/21**

There had been circulated a report proposing the Pension Fund Business Plan 2018/19 and 2020/21 be approved. Best practice suggested that having a Business Plan for the Pension Fund was a good way of demonstrating compliance with the “Myners Principle” relating to effective decision making. Appendix 1, to the report, contained the first Pension Fund Business Plan covering the period 2018/10 – 2020/21. The Business Plan 2018/19 – 2020/21 identified an Action Plan which would be delivered during the next three years to support the aims and objectives of the Pension Fund. Mr Robertson, highlighted Action No. 6 – Implementation of self-service facility, explaining that one of the decisions required to progress this action would be a review of the current Pension Administration system.

DECISION

AGREED that the Pension Fund Business Plan 2018/19 – 2020/21 as set Appendix 1 to the report.

11. **RISK REGISTER UPDATE**

11.1 With reference to paragraph 3 of the Minute of 8 March 2018, there had been circulated a report by the Chief Financial Officer which formed part of the risk review requirements and provided the Pension Fund Committee and Pension Board with a full register and proposed management actions to mitigate risks. Identifying and managing risk was a corner stone of effective management and was required under the Council’s Risk Management Policy and 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. A full risk workshop was undertaken

on 1 May 2018 with officers from relevant departments to review and update the full risk review, the output of which was shown in Appendix 1 to the report. In line with the Council's Risk Management Policy (2015) a paper to be presented at the September 2018 meeting would report progress on the management actions and present any new risk for consideration.

11.2 The report explained that two new risks had been identified. Risk 6.5 – Changes in LGPS Structures, concerned the review being undertaken by The Scheme Advisory Board (SAB) on the structure of the LGPS Funds across Scotland. Ms Robb advised that the next SAB meeting was scheduled for 27 June 2018. The Pension Fund Committee Chair and Vice-Chair would attend and Ms Robb encouraged other members to attend to give their views as part of the consultation. Following discussion, Ms Robb highlighted one of the options being consulted on was pooling which could if following the English and Welsh model, be for the whole of Scotland,. It was noted that these pooling arrangements had incurred huge administration costs and that Funds would need to deliver enhanced performance to cover these costs. The benefit envisaged by the pooling of funds was to reduce asset manager's fees. However, Mr O'Hara advised that the majority of asset managers were already providing fee saving benefits.

11.3 The second new risk category was Risk 7.6 – Reputation. This risk concerned ultra vires Pension Fund actions which resulted in failure to manage the Pension Fund properly. Ms Robb explained that this related to the Pension Fund not fulfilling its judiciary duties with regard to Environmental, Social and Governance (ESG) considerations. This risk would be controlled by providing training for members and officers on their fiduciary responsibilities. It was also proposed to review ESG policy and future monitoring arrangements. In response to a question regarding the risk of losing senior administration staff, Mr Robertson advised that this was covered in Risk 3.1 but that additional controls would be added to this risk.

DECISION
AGREED:

(a) The updated Full Risk register as contained in Appendix 1, to the report; and

(b) To an update on progress of management actions be presented in September 2018.

12. **PENSION FUND BUDGET MONITORING TO 31 MARCH 2018 AND BUDGET 2018/19**
With reference to paragraph 4 of the Minute of 8 March 2018, there had been circulated a report by the Chief Financial Officer providing the Pension Fund Committee and Pension Board with an update position of the Pension Fund budget to 31 March 2018 including proposed budget for 2018/19. The Local Government Pension Scheme (Scotland) Regulation 2014 required Administering Authorities to ensure strong governance arrangements and set out the standards they were to be measured against. To ensure the Fund met the standards a budget was approved on 16 March 2017, following the recommendations within the CIPFA accounting guidelines. The report was the third quarterly monitoring report of the approved budgets and detailed the total expenditure to 31 March 2018 was £8.743m against a budget of £8.208m. The variance of £0.535m had resulted from improved transparency on the investment manager expenses. The budget of £6.389m was proposed for 2018/19 reflecting the current asset allocation and transparency code. The budget would need to be reviewed if the asset allocation was revised.

DECISION
(a) AGREED the proposed budget for 2018/19.

(b) NOTED the actual expenditure to 31 March 2018.

13. **DRAFT ANNUAL REPORT & ACCOUNTS 2017/18**

There had been circulated copies of a report by the Chief Financial Officer presenting for consultation, the draft Annual Report and Accounts for the Pension Fund for 2017/18 prior to submission of the report to Audit & Scrutiny Committee and external auditors. The Local Government Pension Scheme Amendment (Scotland) Regulations 2010 specified the elements which must be contained in the Annual Report and Accounts, the list of these were contained in paragraph 4.1 of the report. The draft Report and Accounts, contained in Appendix 1 to the report, fully met these requirements. The draft Report and Accounts was still subject to statutory Audit, which would commence early July 2018. Following the statutory Audit process the final Report and Accounts would be circulated to the joint Committee and Board. Mr Robertson, referring to Appendix 1 of the report, advised that since publication the net assets had increased to £684.5m with a performance return of 5.6% for 2017/18. Members in receipt of benefits had increased to 3,507. However, the Fund's strong asset position meant that the Fund was well placed to meet its future pension liabilities. Mr Robertson went on to advise that in terms of the Investment Strategy, the Fund was still overweight in equities and that absolute performance of the Fund Managers had been positive. In response to questions, Mr Robertson advised that auto-enrolment had been a positive contribution to the Fund. In terms of Amey Community Limited, he explained that this was an admitted body and included janitors and cleaners transferred to Amey under TUPE regulations.

DECISION

NOTED the Pension Fund Annual Report and Accounts 2017/18, contained in Appendix 1 to the report, prior to submission to Audit and Scrutiny Committee on the 26 June 2018 and the subsequent statutory audit process.

14. **INFORMATION UPDATE**

14.1 There had been circulated a briefing paper by the Pension & Investment Manager and HR Shared Services Team Leader providing members with an update on a number of areas which were being monitored and where work was progressing. Full reports on individual actions would be tabled as decisions and actions were required. In summary:-

14.2 **Guarantee Minimum Pension (GMP) Reconciliation**

With reference to paragraph 5.2 of the Minute of 8 March 2018, Stage 2 of the GMP Reconciliation was progressing by ITM Limited on behalf of Scottish Borders Council (SBC). As at 23 May 2018 at total of 49.02% of discrepancies had been resolved with a further 28.24% under review. SBC continued to receive a monthly update on progress from ITM Limited.

14.3 **General Data Protection Regulations (GDPR) Update**

With reference to paragraph 6 of the Minute of 8 March 2018, FAQs for LGPS members went live on the Pension Fund website on 5 June 2018. A privacy notice in relation to LGPS was currently being prepared and would be available on the website from 14 June 2018.

14.4 **Environmental, Social and Governance Policy (ESG)**

With reference to paragraph 7 of the Minute of 8 March 2018, the Pension Fund was reviewing its current policy and investigating how it would monitor the Fund Managers' approach to ESG against this policy. An updated policy and a recommended process would be presented to the joint Pension Fund Committee and Pension Board on 13 September 2018.

14.5 **Scheme Advisory Board**

With reference to paragraph 5.4 of the Minute of 8 March 2018, the Scheme Advisory Board met on 26 April 2018, a note of the meeting had been attached to the briefing paper for information.

14.6 **Scottish Futures Trust (SFT) Infrastructure**
SFT had been asked to progress the development of an investment vehicle to allow pension funds to invest in infrastructure including schools, hospitals, etc., and were consulting with all LGPS funds across Scotland. Mr O'Hara explained that SFT's consultation had shown that most funds were keen to collaborate to enable infrastructure investment but that SFT had been unable to identify suitable projects. A report from SFT on the way forward would be issued next week and there would be an update at the next meeting.

14.7 **Training Opportunities**
Baillie Gifford were holding an Investment conference on 25-27 September 2018. There would also be a Pension Fund officers' annual training event on 10 September; an agenda would be circulated when available. The Pension and Lifetime Savings Association (PLSA) conference would be held on 6 – 8 March 2019. Pension Fund Members and Board Members were asked to contact Ms Robb if they were interested in attending any of the above mentioned training events.

14.8 **Future Meeting Dates**
The next meeting was scheduled to be held on 13 September. There had been a couple of minor changes to meeting dates and they were now confirmed as follows:-

Joint Pension Fund Committee and Pension Fund Board:	14 June 2018 13 September 2018 11 December 2018 7 March 2019 13 June 2019
Performance & Investment Sub-Committee	22 August 2018 29 October 2018 25 February 2019 24 June 2019.

DECISION
NOTED the information update.

15. **ITEMS LIKELY TO BE TAKEN IN PRIVATE**
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

16. **MINUTE**
The Committee noted the Private Minute of the meeting of 8 March 2018

17. **PENSION FUND INVESTMENT PERFORMANCE SUB-COMMITTEE**
The Committee noted and agreed the Private Minute of the Pension Fund Investment and Performance Sub Committee on 26 February 2018.

18. **QUARTER PERFORMANCE UPDATE**
The Committee considered a Private report by KPMG.

The meeting was adjourned at 12.30 pm and resumed at 12.50 pm

19. **INFRASTRUCTURE INVESTMENT UPDATE**

The Committee noted a private report by the Chief Financial Officer regarding an infrastructure investment made by the Fund under delegated authority.

The meeting concluded at 1.05 pm

SCOTTISH BORDERS COUNCIL
PENSION FUND INVESTMENT AND PERFORMANCE SUB-COMMITTEE

MINUTES of Meeting of the PENSION FUND INVESTMENT AND PERFORMANCE SUB-COMMITTEE held in the Dundas Room, Clydesdale Bank, 83 George Street Edinburgh on Wednesday, 22 August 2018 at 11.00 am

_____

Present:- Councillors D Parker (Chairman), J Brown, G Edgar, J Fullarton, D Moffat, S Mountford, S Scott, Ms K M Hughes and Mr P Smith.

In Attendance:- Chief Financial Officer, Pension & Investments Manager, Mr D O'Hara, Investment Advisor (KPMG), Mr A Hodgson Support Consultant (KPMG) and Democratic Services Officer (J Turnbull).

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**
The Committee noted the Minute of the meeting of 26 February 2018

3. **ITEMS 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 grounds that they involved the likely disclosure of exempt information as defined in paragraphs 6 and 8 of part 1 of Schedule 7A to the Act.

SUMMARY OF PRIVATE BUSINESS

4. **PRIVATE MINUTE**
The Sub-Committee noted for signature the Private Minute of 26 February 2018.

5. **ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) RECAP**
The Committee discussed the recap by KPMG.

6. **JUNIOR COMMERCIAL REAL ESTATE & INFRASTRUCTURE DEBT**
The Committee considered a report by KPMG.

7. **INVESTMENT STRATEGY HEALTH CHECK**
The Committee noted the report by KPMG.

8. **PRESENTATION – BAILLIE GIFFORD**
The Committee noted the presentation by Baillie Gifford.

9. **QUARTER PERFORMANCE TO 30 JUNE 2018**
The Committee noted a report by KPMG.

10. **INVESTMENT MANAGERS**
The Committee noted a report by KPMG.

11. PRESENTATION - HARRIS ASSOCIATES

The Committee noted the presentation by Harris Associates.

12. PRESENTATION - MORGAN STANLEY

The Committee noted the presentation by Morgan Stanley.

The meeting concluded at 4.20 pm

PENSION FUND BUDGET MONITORING TO 30 JUNE 2018

Report by Chief Financial Officer

JOINT PENSION FUND COMMITTEE AND PENSION FUND BOARD

13 September 2018

1 PURPOSE AND SUMMARY

1.1 **The purpose of this report is to provide the Pension Fund Committee and Pension Fund Board with an update position of the Pension Fund budget to 30 June 2018 including projections to 31 March 2019.**

1.2 The Local Government Pension Scheme (Scotland) Regulation 2014 requires Administering Authorities to ensure strong governance arrangements and sets out the standards they are to be measured against.

1.3 To ensure the Fund meets the standards a budget was approved on 14 June 2018 following the recommendations within the CIPFA accounting guidelines headings. This report is the first quarterly monitoring report of the approved budgets.

1.4 The total expenditure to 30 June 2018 is £0.080m with a projected total expenditure of £6.839m. The projected expenditure is in line with budget..

2 RECOMMENDATIONS

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

(a) Notes the actual expenditure to 30 June 2018; and

(b) notes the projected expenditure

3 BACKGROUND

3.1 The Local Government Pension Scheme (Scotland) Regulation 2014 requires Administering Authorities to ensure strong governance arrangements and sets out the standards they are to be measured against. The Fund is required to report on an annual basis within its Annual Report if it has met these standards. To demonstrate full compliance requires the setting and monitoring of a budget for the Fund.

3.2 A budget was approved at the Joint Pension Fund Committee and Pension Fund Board meeting on 14 June 2018 for 2018/19. The approved budget follows the Local Government Pension Scheme management costs guidance issued by CIPFA into the following 3 categories.

Category	**Costs included**
Investment Management	All expenses incurred in relation to management of pension fund assets. Including costs invoiced direct and fees deducted from fund assets. Custody and performance fees also included
Administration	Costs incurred in administration of the fund including staff, IT costs and associated overheads, benefits consultants.
Oversight and governance	Costs incurred in the selection & appointment of managers, audit fees, investment advisory services, tax advisory, accounting services, banking service and support to the pensions committee and board.

4 MONITORING TO 30 JUNE 2018

4.1 The table below shows the expenditure to 30 June 2018, projected out-turn to 31 March, full year budget

	Expenditure to 30 June 18 £000's	Projected to 31 March 19 £000's	2018/19 Budget £000's	2018/19 Variance £000's
Investment Management	72	5,792	5,792	0
Administration	40	368	368	0
Oversight & Governance	(32)	241	241	0
Total	**80**	**6,389**	**6,389**	**0**

4.2 Investment Management fees are charged on a quarterly basis in arrears based on the value of assets held on a quarterly basis. The first quarter investment management fees are not therefore included in the expenditure to 30 June 2018 totals.

4.3 The invoices for the Custodian accrued for the final quarter of 2017/18 were unpaid at 30 June 2018 due to a delay in the invoicing at Northern Trust. This has resulted in the credit expenditure figure under oversight & governance.

5 IMPLICATIONS

5.1 Financial

There are not costs attached to any of the recommendations contained in this report.

5.2 Risk and Mitigations

This report is part of the governance framework to manager the operation of the Pension Fund and reflects the compliance with the best practice recommendations. Risk are managed in line with the Corporate Risk Management framework, with risks and controls monitored and reported on a quarterly basis.

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

There are not changes to the Scheme of Administration or the Scheme of Delegation 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 Service Director HR and the Clerk to the Council have been consulted and their comments have been included in the report.

Approved by

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

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Pension & Investment Manager, 01835 825249

Background Papers:
Previous Minute Reference: Joint Pension Fund Committee and Pension Fund Board 14 June 2018

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Pension and Investment

Team can also give information on other language translations as well as providing additional copies.

Contact us at Contact us at: Pension & Investment Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825249 Fax 01835 825166.
email: treasuryteam@scotborders.gov.uk

RISK REGISTER UPDATE

Report by Chief Financial Officer

JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION BOARD

13 September 2018

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 actions taken by management to mitigate these 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 A full risk review was undertaken on 1 May 2018 and the revised risk register was approved by the Joint Pension Fund Committee and Pension Fund Board on 14 June 2018.

1.4 Appendix 1 details the risks within the approved risk register which have been identified management, actions and the progress of these actions to date.

2 RECOMMENDATIONS

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

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

(b) Notes the revised scores for risks 4.1 and 5.5

(c) Notes no new quantifiable risks have been identified since the last review; and

(d) Agrees to a key risk review being undertaken in December 2018 and reporting of progress on the risk management actions.

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 2018/19 – 2020/21 was approved on 14 June 2018, setting out the aims and objectives of the Pension Fund. These aims and objectives 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 1 May 2018 by Officers in order to ensure that the risk register's contents were still relevant and up-to-date.

The outcome of the workshop was then considered and approved at the Committee/Board meeting on 14 June 2018**.** This report provides the quarterly review of risks and the progress of the actions.

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

4.3 With the fund moving to a mature basis to ensure funds were available and fund were available to pay liabilities as they became due risk 4.1 identified additional controls were required around the cashflow. Work has now been completed on this with the cash flow gap being identified. Income from the Private Credit, long lease property and the M&G Diversified credit fund will be drawn down with any remaining gap being funded from equities as required. The positon will be reviewed and monitored on a ongoing basis. This additional work has resulted in the impact and likelihood being rescored from 3's to 2's giving the overall score of 4.

4.4 The fund identified the failure to hold personal data securely as a key risk and agreed an additional control to review all records meet the new GDPR regulations, risk 5.5. A review of the regulations was undertaken across the Council and training has been completed by all Pension Administration staff. A GDPR policy has also been developed for the Pension Fund and has been published on the website. A monitoring process to ensure the regulations are adhered to has also been put in place. This has fully completed the required work and has resulted in the likelihood score being reduced from 3 to 2 giving overall score of 4.

5 IMPLICATIONS

5.1 Financial

There are no direct financial implications of this report.

5.2 Risk and Mitigations

The purpose of providing the update to the Committee and Board is to improve the risk management framework for the Pension Fund and 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 are designed to directly enhance the management of risks.

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 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 Service Director HR and the Clerk to the Council have been consulted and their comments have been included in the report.

Approved by

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

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Pension & Investment Manager, 01835 825249

Background Papers:
Previous Minute Reference: Pension Fund Committee and Pension Board 14 June 2018

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

Contact us at: Pension & Investment Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825249 Fax 01835 825166. email: treasuryteam@scotborders.gov.uk

APPENDIX 1

Pension Fund - Full Risk Register

							Controls		Current Risk			Progress
No.	Category	Risk	Risk Factor/Cause	Effect/Consequences	Proximity	Risk Owner	Current Controls	Control Assessment	Impact	Likelihood	Score	Actions as at 30/06/2018
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. TREAT 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.	Effective	4	3	12	Training requirements being actioned as part of Training plan to ensure have required skills and knowledge to enable challenge. Letter to Members issued to highlight training requirements. Finalising performance monitoring and accounting information available from Custodian.
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.	Wrong or inappropriate decisions 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; Investment Adviser in place and performance reviewed annually Benchmark performance against other LAs; Regular benchmarking and cross verification of advice with other LAs through Local Govt. Pension Scheme(Scotland) Investment & Governance Group; Other info sources and discussions with non-Fund investment managers/advisers to validate advice and performance of Fund; Pension Fund Board provides scrutiny role TREAT 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 have required skills and knowledge to enable challenge. Letter issued to all members to highlight annual training requirements.
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	future liabilities of the Fund not being able to be covered by its assets; Employers 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. TREAT Additional Actions Proposed: Undertake a full investment strategy review following 2017 valuation.	Effective	2	2	4	Final report to on triennial valuation completed 31 March 18. Review of investment strategy undertaken and being presented to Committee and Board.
2.2	Employer	Adoption of either an inappropriately slow or rapid pace of funding rates for different employers may result in improper management of the Fund and result in inappropriate employer contribution rates and a possible shortfall in assets to cover the employer's liabilities.	Failure by employer to notify the fund of significant changes of membership.	Improper management of the Fund; Inappropriate employer contribution rates and a possible shortfall in assets to cover the employer's liabilities.	Ongoing	Pension Fund Committee/ Chief Financial Officer	Full actuarial valuation undertaken on Triennial basis, 2017 valuation completed; Review Pooling arrangements at each Valuation and implement appropriate de-pooling e.g. SBHA & CGI to reflect employer situations; Annual declaration made by each Employer for forth coming changes Ensure full reporting of options are presented to the Committee and Board when employer circumstances change to ensure decision making fully informed. TREAT Undertake next valuation for 2020	Effective	2	2	4	2017 valuation completed. Tenders issued for procurement of Actuarial services to ensure any change fully embedded prior to 2020 valuation.

APPENDIX 1

Pension Fund - Full Risk Register

							Controls		Current Risk			Progress
No.	Category	Risk	Risk Factor/Cause	Effect/Consequences	Proximity	Risk Owner	Current Controls	Control Assessment	Impact	Likelihood	Score	Actions as at 30/06/2018
3.5	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.	Changes in legislation; New investment types and vehicles; Lack of documented procedures.	Failure to manage the Fund effectively.	Ongoing	Chief Financial Officer/ Service Director of HR	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; Produce notes completed 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 updating of procedure notes currently being developed following implementation of Business World. A number have been completed and tested. Will continue to prioritise the remain processes for perceived high risk and possible quick wins.
4.1	Liquidity	Changes in composition of Pension Fund membership, i.e. active/deferred/pensioners may lead to 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.	Variance between CPI rates and pay increases; Fewer people joining; Other employers close funds; Economic drivers to reduce workforce.	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 of membership changes. Close monitoring of early retiral decisions and quantification of impact on pension fund being included as part of the Council reports; Estimated monthly cashflow identified TREAT Additional Actions Proposed: Review of Investment strategy to identify investment income to be claimed	Partially Effective	2	2	4	Cash flow work complete and gaps identified and work completed with Advisors to agree future draw down from Managers of dividends to fund gap.
4.3	Liquidity	Significant differences between Actuarial Assumptions in the Triennial Valuation Reports and reality may lead to setting Funding and Investment Strategies which may result in insufficient cashflow to fund current obligations or insufficient funding to cover future liabilities	CPI inflation; Mortality levels; Investment Returns.	Setting Funding and Investment Strategies; Insufficient cashflow to fund current obligations or insufficient funding to cover future liabilities; Increased employer contributions.	Ongoing	Chief Financial Officer	Full actuarial valuation undertaken on Triennial basis; Detailed dialogue with Actuary ahead of valuation to agree evidence based assumptions to be used; Regular information provided by Actuary on differences as they occur from assumptions. Any strain on fund incurred paid by employer at point of retirement; Regular monitoring of investment performance and where medium to long term trend in returns is identified then this will be reviewed. TREAT Additional Actions Proposed - undertake market testing of Actuarial services	Effective	2	3	6	Tenders documents issued on 24th August under Norfolk framework
4.6	Liquidity	Failure to manage the liquidity required for the Fund's cashflows may lead to assets being sold at unattractive times or investment opportunities missed due to unavailability of cash, resulting in an adverse impact on the valuation of the Fund's assets.	Higher than anticipated levels of retirement; Higher levels of lump sums commutation taken on retirement.	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; Estimated monthly cash shortfall identified TREAT Additional Actions Proposed: Improve quality of medium term cashflow forecasting for the Fund; Asset allocation review to review cash flow projections requirements;	Partially Effective	2	2	4	Cash flow work complete and gaps identified and work completed with Advisors to agree future draw down from Managers of dividends to fund gap.

APPENDIX 1

Pension Fund - Full Risk Register

							Controls		Current Risk			Progress
No.	Category	Risk	Risk Factor/Cause	Effect/Consequences	Proximity	Risk Owner	Current Controls	Control Assessment	Impact	Likelihood	Score	Actions as at 30/06/2018
5.4	Administrative	Failure to prevent fraud or misappropriation by scheme member, employee or scheme employer within the Fund may lead to loss of funds.	Lack of monitoring; Lack of segregation of duties.	Inability to provide a high quality pension service to members; Financial loss to the Fund; Impact on benefits paid to members.	Ongoing	HR Shared Services Manager	Robust segregation of duties and other internal controls to mitigate against this risk; Immediate action taken upon discovery of fraud; Internal & External Audit programme also picks up the monitoring of this risk. TREAT Additional actions proposed - to request from each External Employers audited accounts to provide assurance on their internal controls	Effective	2	2	4	Review of accounts and internal control process's completed as part of 2017/18 Annual Account process. Will be undertaken on Annual basis as part of year end accounts.
5.5	Administrative	Failure to hold personal data securely resulting in personal data loss, reputational damage and potential financial penalty	Lack of controls; Lack of monitoring; Lack of procedures; Lack of training and awareness.	Data lost or compromised; Reputational risk; Potential financial Penalty from Information Commissioner.	Ongoing	HR Shared Services Manager	Pension administration system implemented; Business World 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 mandatory Data Protection and fully compliant with SBC Info. Governance requirements. Mandatory GDPR course undertaken by all staff. TREAT Additional action proposed - to review all records meet the new GDPR regulations	Effective	2	2	4	Training for all staff completed and GDPR policy published. Monitoring process in place
6.2	Regulatory & Compliance	Changes in legislation and other regulatory frameworks may impact adversely on the Fund in terms of funding levels and governance structures	Central Govt. legislation changes.	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/ Service Director of HR	Participation in active CIPFA and Scottish Pension network allow changes and impacts to be identified quickly; Involvement with COSLA discussions on Pensions; Monitoring and highlighting actions and decisions from scheme advisory board; TREAT Additional Actions 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. Monitoring Scheme Advisory Board web site on monthly basis
6.5	Regulatory & Compliance	Changes in LGPS Structures	Review by Scheme Advisory Board on LGPS structures	Fund may cease to exist, assets may be pooled, Administration could pooled	Ongoing	Chief Financial Officer	Monitoring of political position via Scheme Advisory Board TREAT Additional actions proposed - Actively engage with Scheme Advisory Board and consultants undertaking review	Partially Effective	3	4	12	Preparing response to consultation and working with other Scottish LGPS funds to provide full response and workable options to consultation by deadline of 7th December 2018.
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	Lack of capacity of Officers to monitor.	Failure to achieve Pension Fund objectives; Inappropriate management of the Fund resulting from poor advice to decision makers; Legal challenge	Ongoing	Chief Financial Officer/ Service Director of HR	Identify requirements of external advisers and appoint appropriately. Annual review undertaken with Investment Advisor and Custodian for 2017 TREAT Additional Actions proposed: Implement annual review of Advisers;	Effective	2	2	4	Review meetings scheduled with Investment Advisor and Custodian during October.
7.6	Reputation	Pension Fund does not fulfil its judiciary duties with appropriate regard with its ESG responsibilities	Lack of skills & knowledge Lack of information from Managers Lack of clear policy	Failure to manage the Pension Fund properly; Financial loss; Reputation damage.	Ongoing	Chief Financial Officer	Training provided to Members and Officers on their roles and fiduciary responsibility; Monitoring on quarterly basis of Segregated Portfolios voting Policy contained with Statement of Investment Principles including support for UNPRI TREAT Additional Actions Proposed review of ESG policy and future monitoring arrangements	Partially Effective	2	2	4	ESG principles being presented and discussed at September meeting to allow Statement of Investment Principles and ESG policy to be agreed in December.

This page is intentionally left blank

PENSION ADMINISTRATION STRATEGY

Report by Service Director Human Resources

JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION BOARD

13 September 2018

1 PURPOSE AND SUMMARY

1.1 **This report proposes the revised Pension Administration Strategy for the Scottish Borders Council Pension Fund.**

1.2 The Pension Fund is required by the Local Government Pension Scheme (Scotland) Regulations 2018 to have an up-to-date Pension Administration Strategy.

1.3 **Appendix 1** contains the revised Pension Administration Strategy which contains only minor amendments to the previously approved document – mainly Appendix A Scheduled and Admitted Bodies and updated references from the 2014 to 2018 regulations.

2 RECOMMENDATIONS

2.1 **It is recommended that the Pension Administration Strategy as set out in Appendix 1 is approved.**

3 BACKGROUND

3.1 Regulation 57 of the Local Government Pension Scheme (Scotland) Regulations 2018 advises that an administering authority should maintain its Pension Administration Strategy and keeps this under review following material changes in policies.

4 PENSION ADMINISTRATION STRATEGY

4.1 **Appendix 1** contains the revised Pension Administration Strategy (PAS).

4.2 As a result of the review, it has been established that there were no fundamental changes required.

4.3 There have only been minor updates to the previously approved PAS as a result of changes to the Regulations, Admitted Bodies names and status along with NI Contracted-out changes:-

- References to the 2014 Regulations have been updated to the 2018 Regulations
- Section 3.3 has been updated to reflect the change in the Councils Departmental structure – change of name from Treasury Management Section to Pensions/Investments Section
- Appendix A to show L&B Community Justice Authority are no longer an active admitted body and have been moved to Admitted Bodies with deferred or retirement members only. Borders Sports and Leisure Trust are now known as LIVE Borders and the addition of CGI as a new admitted bodies
- Appendix B – the removal of employer responsibility to pay NI Contributions at the contracted out rate – the contracted out rate was removed by HMRC on 5 April 2016.

5 IMPLICATIONS

5.1 **Financial**

There are no financial implications relating to this report.

5.2 **Risk and Mitigations**

This report is part of the governance framework to manage the operation of the Pension Fund and ensure compliance with the scheme regulations.

5.3 **Equalities**

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

5.4 **Acting Sustainably**

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

5.5 **Carbon Management**

No effect on carbon emissions are anticipated from the recommendation 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 either the Scheme of Administration or the 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 in the preparation of this report and any comments received have been incorporated into the final report.

6.2 The Admitted and Scheduled Bodies have been consulted on the Pension Administration Strategy, at Appendix 1, and their comments taken into account.

Approved by

Clair Hepburn **Signature .....**
Service Director Human Resources

Author(s)

Name	Designation and Contact Number
Anthea Green	HRSS Team Leader, 01835 826722

Background Papers:
Previous Minute Reference:

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

Contact us at Anthea Green, HR Shared Services Team Leader, Council Headquarters, Newtown St Boswells, Melrose, TD6 0SA; Tel: 01835 826722; Fax: 01835 825011; E-mail agreen@scotborders.gov.uk.

This page is intentionally left blank

SCOTTISH BORDERS COUNCIL PENSION FUND

PENSION ADMINISTRATION STRATEGY

HR Shared Services
Chief Executives Department
Version 2018 1.7 DRAFT
Approved: Joint Pension Fund Committee and Pension Board [13 September 2018]

1. Introduction

1.1 Scottish Borders Council administers the Local Government Pension Scheme (LGPS) on behalf of Employers participating in the Scheme through Scottish Borders Council Pension Fund, see Appendix A. The administration of the Scheme is governed by statutory regulations[1].

1.2 Scottish Borders Council, as an Administering Authority, is committed to providing a high quality pension service to both members and Employers and ensuring members receive their correct pension benefit entitlement. These aims are best achieved where the Fund and Employers work in partnership and are clear about their respective roles and responsibilities. The Fund's role includes investing contributions from members and Employers, maintaining member records and calculating members benefits based on information supplied by Employers. The quality of service provided to members is therefore dependent on both parties meeting high standards of accuracy and timeliness of information supplied.

1.3 This document sets out the roles and responsibilities of both the Fund and Employer. It also specifies the level of services the parties will provide to each other and the performance measures used to evaluate them.

2. Pension Administration Strategy Statement

2.1 The strategy statement has been produced in consultation with Employers and was approved by the Joint Pension Fund Committee and Pension Board on [13 September 2018]. The strategy will be kept under review and revised where appropriate. Changes will be subject to consultation with Employers. The strategy will be issued to all participating Employers.

2.2 References to the Fund should be regarded as meaning Scottish Borders Council as Administering Authority of the Local Government Pension Scheme.

2.3 In agreeing to this strategy, all parties commit to the following principals:

- Achieving a high quality pension service to employees
- Continually developing and improving efficient working arrangements
- Striving to exceed the Fund's service standards
- Reporting annually on performance
- Keeping the Pension Administration Strategy under review.

[1] The Local Government Pension Scheme (Scotland) regulations 2018 as amended, The Local Government (Transitional Provisions and Savings) (Scotland) Regulations 2014 as amended.

3. Administration and Management of the Fund

3.1 This is shared over two Services within the Chief Executives Department.

3.2 **Administration**

The pension benefit policy oversight and day-to-day administration for the Fund is managed by the HR Shared Services Team within Human Resources.

3.3 **Management**

The Council's Chief Financial Officer is the Officer with responsibility to ensure proper administration of the Council's financial affairs in terms of Section 95 of the Local Government (Scotland) Act 1973.

He is responsible for:

- the financial accounting of the Fund,
- the preparation of the Pension Fund Annual Report, and
- being the principal advisor on investment management to the Council in its capacity as Trustee to the Fund and as the Fund's Administering Authority.

The day-to-day management of the investment activities of the Fund is managed by the Pensions/Investments Section within the Finance Service.

4. Roles and Responsibilities

4.1 The duties, responsibilities and discretions of Employer's are listed in Appendix B, and the Fund's duties, responsibilities and discretions are listed in Appendix C.

4.2 Responsibility for the review of the Pension Administration Strategy will fall to HR Shared Services on behalf of the fund. However, all Employers will be consulted on changes prior to seeking approval at the Joint Pension Fund Committee and Pension Board.

4.3 The Joint Pension Fund Committee and Pension Board oversee the management of the Scottish Borders Council Pension Fund (the Fund). The Scheduled and Active Admitted Bodies are represented as members of the Pension Board.

4.4 To improve communication with all Scheduled and Active Admitted Bodies the Fund will introduce Employer Liaison Meetings, with meetings held once a year. The meetings will be held in February to coincide with preparations for the year end and provide the opportunity for information to be conveyed with regard to any potential changes for the coming year.

5. Service Standards

5.1 Service standards expected from the Employer

Required information about members will generally be provided on the Fund's forms, authorised by an appropriate signatory. The following are the agreed standards at which the information detailed below will be provided:

- When a new employee joins the Scheme, the Employer will notify the Fund **within 20 working** days of commencing pension scheme deductions.
- The Employer will notify any member's change in pensionable circumstances **within 20 working days** of the change.
- Where a member is leaving the scheme with a right to immediate payment of retirement benefits, the Employer will, provide the Fund with all of the necessary information and certificates required **at least 20 working days before** the member's last day of service.
- Where a member leaves the Scheme and does not have a right to immediate payment of retirement benefits, the Employer will provide the Fund with all the necessary information to enable them to process the member as a leaver as soon as possible after notification by the member and **no later than 20 working days after** the member's last day of service.
- When a member dies in service the Employer will provide the Fund with all of the necessary information and certificates to enable them to make payment of any death grant and dependants' benefits due as soon as possible but no later than **10 working days** of the death of the member.
- The Employer will respond to queries raised by the Fund, with the exception of those resulting from the annual year end routines, **within 10 working days** of receipt.
- The Employer will pay employee contributions to the Fund, along with the Employer contributions certified in the latest actuarial valuation, **by the 19th of the next month** following deduction. Interest will be charged for late payment of contributions in accordance with regulations.
- The Employer will provide the Fund with year-end information to 31st March in an approved format by the 30th April each year, including a statement reconciling the amounts paid during the year with the totals on the year end return. Any queries arising from the year-end information will be answered **within 20 working days** of receipt.
- The Employer will notify the Fund of any changes in the personnel details provided in Appendix D.

5.2 Service standards Employers can expect from the Fund

The Fund will endeavour to provide the information below within the agreed timescales shown. A reduced timescale may be agreed in exceptional circumstances at an Employer's request.

- Where all required information is provided, the Fund will provide the Employer with ad-hoc estimates of benefits **within 10 working days** of the receipt of the request. Where more than 20 individual estimates are required, the Employer must consult with

the Fund to reach an agreed timescale. Multiple requests relating to an individual member may be restricted.

- The Fund will respond to a pension-related query raised by the Employer **within 10 working days** of receipt.

- Benefit statements, leaflets and other correspondence will generally be issued directly to members' home addresses, where available. The Fund will advise Employers of the general content and planned issue date of such material in advance.

- The Fund will issue benefit statements by **end of August** on an annual basis.

- Employers have responsibility for ensuring the accurate provision of information to their members. The Fund is not responsible for checking the accuracy of any information provided by the Employer. However, the Fund will inform the Employer of any discrepancies between information provided by the Employer and information already held.

- As the body administering the scheme on behalf of the Employer, the Fund will consult with the Employer on major issues affecting their participation in the LGPS and keep it up to date with relevant information through:

  - Website
  - Employer bulletins
  - Employer events
  - Consultative panel meetings

- The Fund will provide training, guidance and support to staff who have pension related duties as required by the Employer.

6. Performance measurement and reporting

6.1 The Fund will monitor, measure and report on both the Fund's and Employers' compliance with the agreed service standards and will share that report annually with Employers. These and other performance measures to be reported are detailed in Appendix E.

6.2 Where information collected for reporting purposes reveals issues with meeting the standards, the Fund will consult and work with the relevant Employers to improve the level of compliance and performance by providing support, guidance or training as considered necessary.

6.3 The Fund will carry out its duties and responsibilities to members in accordance with its service standards. It will also monitor, measure and report on its performance against those standards and its performance targets.

7. Costs

7.1 The costs of administration, including actuarial fees for routine work, are charged directly to the Fund. These costs are taken into account in assessing Employers' contribution rates.

7.2 Where additional services (actuarial or other) are required by, or result from the actions of the Employer and costs are incurred by the Fund, the Employer will be liable for the costs involved. Where appropriate, an estimate of these costs will be provided and the Employer's agreement obtained before proceeding to instruct the service provider.

8. Penalties

8.1 It is hoped that through commitment to the principles of this statement (see 2.3 and 5.2), any non-compliance issues arising would be addressed promptly and there would be no need to resort to any punitive action. However, for completeness the following actions are possible:

- In the event of a failure to meet its requirements, the Fund will be penalised in accordance with The Occupational Pensions Schemes (Disclosure of Information) Regulations.
- The Fund may appeal to Scottish Ministers against a decision, or failure to make a decision, under scheme regulations by an Employer.
- Persistent failure to comply with contribution payment requirements will result in the Fund informing the Pensions Regulator, as required of Scheme Administrators by the Pensions Act 1995.
- Where the Employer fails to comply with the scheme duties etc., including the failure to make payment of contributions due, the fund reserves the right to notify the member(s) involved and to notify all members employed by the Employer in the event of serious or persistent failure.
- If as a result of an Employer's poor performance, additional and disproportionate resources are deployed by the Fund, the cost of such additional resource may be re-charged to the Employer in accordance with the powers available under scheme regulations. Written notice will be provided of the reasons for re-charge, the basis of calculation of the amount, and the relevant part of this strategy which, in the Fund's opinion, has been contravened.
- Where any orders or instruction issued by The Pensions Regulator or Pensions Ombudsmen requires financial compensation or a fine to be paid from the Fund, or by any officer responsible for it, and it is due to the default, omission or otherwise negligent act of the Employer, the sum concerned will be recharged to the Employer.

Appendix A – Scheduled and Admitted Bodies

Scheduled Bodies

- Borders College
- Scottish Borders Council
- Visit Scotland

Admitted Bodies

Active Admitted Bodies

- Amey Community Limited
- BC Consultants
- Live Borders (formerly Borders Sport and Leisure Trust)
- Jedburgh Leisure Facilities Trust
- Scottish Borders Housing Association
- SB Cares LLP
- SB Supports LLP
- CGI

Admitted bodies with Deferred or Retired Members only

- Berwickshire Housing Association
- Heriot Watt (former Scottish College of Textiles)
- Project ’80 Council Burnfoot
- Red Cross Housing Association
- Scottish Borders Careers
- Stable Life (formerly GYP)
- Lothian and Borders Community Justice Authority

Appendix B – The Role and Responsibilities of the Employer

1. Main duties under scheme regulations

- To decide those employees eligible to become members of the Scheme. If eligible, a new employee must be treated as a member of the Scheme unless he/she elects otherwise.
- To supply timely and accurate information to the Fund regarding new members, leavers and material changes in employment required for pension administration purposes.
- To determine whether members are employed in a full time, part time or variable time capacity. For part time, to determine the proportion of comparable full time hours.
- To determine an employee's pay (or fees) for the purposes of calculating pension contributions and to determine final pay for the purposes of calculating benefits due from the Scheme.
- To determine an employee's annual contribution rate on the basis of the person's pensionable pay having regard to guidance issued by the Scottish Ministers. To collect, pay over and account for the deduction of the correct rate of pension contributions payable by both the employee and the Employer.
- To notify, in writing, every person whose rights or liabilities are affected by a 'first instance decision' made by the Employer under the 2018 Regulations (see Regulation 70 of the Local Government Pension Scheme (Scotland) Regulations).
- To appoint a person designated to receive appeals from employees on 'first instance decisions' under the 2018 Regulations
- To accompany any statement issued to an employee relating to any decision made about the scheme, with a notice drawing the employee's attention to their right of appeal under the LGPS. However, it should be noted that the Fund will normally issue, on behalf of the Employer, a Statutory notice detailing membership details, including such a notice when a member joins the Fund or where there is a change in a member's pension records.
- To notify the Fund of any employee's election to pay Additional Voluntary Contributions, to deduct from the member's pay the specified amount and to pay over those amounts to the specified AVC provider. To notify the Fund of any subsequent election to vary or cease paying AVC contributions and to ensure that final payments are made to the provider before a member's retirement.
- To notify the Fund of a material reduction in the member's pay, (or a restriction in the rate by which it may be increased), where the reduction or restriction arose otherwise than by virtue of the member's own volition.
- To use an independent Medical Officer qualified in Occupational Health Medicine, (who has been approved by the Fund), in determining ill-health retirement and provide the Fund with a relevant certificate where appropriate.
- To determine a member's entitlement to benefit on cessation of scheme membership, employment or on a member's application for early release of benefits or flexible retirement and provide early retirement request to the Fund as and when appropriate.

2. Responsibilities

In addition to the duties above, the Employer's responsibilities are summarised as follows:

- To provide prospective members with basic information about the Scheme using, where appropriate, material provided by the Fund.
- To maintain employment records for each scheme member, for the purpose of determining membership and entitlement to pension benefits.
- To ensure all relevant information is provided for new members, leavers and changes to pay and service records for pension purposes. Data provided should comply with Data Protection legislation and secure transfer methods must be adopted.
- To provide additional information as required for actuarial valuation, year end processing, data-matching or communication purposes. The specification for this will be provided by the Fund and may, after consultation, be modified from time to time.
- To pay monthly contributions due to the Fund, using agreed payment method.
- To ensure those not joining the scheme are fully aware of the benefits given up and that equalities principles are met.
- To make payment to the Fund, by lump sum and within prescribed time limits, any amounts arising as a result of the Employer's decision to increase total membership and/or increase annual pension under the 2018 Regulations.
- To decide whether to award additional compensatory years under the Discretionary Regulations. At the request of the Employer, the Fund will calculate and pay the benefits arising as a result of the Employer awarding additional compensatory years along with the main scheme benefits, and the Employer will reimburse the Fund for all such amounts paid.
- To advise members awarded additional compensatory years that the payment of the award will be subject to restriction should they take up further employment with an Employer participating in the LGPS.
- To pay the Fund, by lump sum payment and within prescribed timescales, any strain costs arising from a decision made by the Employer to award early payment of benefits.
- To ensure the Fund is informed about, and Government guidance is followed in respect of, any transfer of members in respect of an outsourcing of service arrangement, and any subsequent changes to that arrangement which would impact on those members.
- To inform the Fund of any planned changes to their pension provision for employees, including whether the scheme is open to new employees, bulk transfers of employment or any redundancy exercises as soon as possible.
- To provide details of officers or representatives who are to receive Employer communications issued by the Fund and keep these up to date as necessary.
- To provide details of officers or representatives who are authorised to sign Fund forms and to ensure all forms submitted to the Fund have been signed by an authorised signatory.

3. Discretions

The Employer is obliged to make, and keep under review, policies on the discretions available under the regulations. These policies must be contained and published in a policy statement. A copy of that statement, and any subsequent amendment to it, must be provided to the Fund. The current statement must also be made available to any scheme member upon request.

Guidance on establishing policies required is available from the Fund on request.

Appendix C – The Role and Responsibilities of the Fund

1. Main duties under scheme regulations

- To maintain the Scottish Borders Council Pension Fund.
- To invest pension contributions received and account for and manage the Fund's assets.
- To set up and maintain a record for each member which contains all the necessary information for the production of an accurate benefit calculation.
- To decide how any previous service or employment of an employee is to count for pension purposes, and whether such service is classed as a 'period of membership'.
- To notify each member of their decisions regarding the counting of service or additional pension.
- To calculate and pay the appropriate benefits, based on the member's record, and the termination and pay details provided by the Employer when an employee ceases employment.
- To calculate and process transfers of members pension rights inwards and outwards.
- To supply members with a Membership Certificate on commencing membership, or on an increase in membership following an inwards transfer of pension rights.
- To issue a Certificate of Protection of Pension Benefit if requested to do so by an Employer within 12 months of a material reduction in a member's pay, (or a restriction in the rate by which it may be increased), where the reduction or restriction arose otherwise than by virtue of the member's own volition. Where such a certificate is issued, to keep a record of the member's pay for the period commencing 3 years before the effective date of the certificate and ending 10 years after the effective date of the certificate.
- To supply survivor beneficiaries with notification of their entitlements including the method of calculation.
- To appoint a suitable person for the purposes of the scheme's internal dispute resolution procedure.
- To increase pensions annually in accordance with the provisions of Pensions Increase Acts and Orders.
- To produce and issue annual pension forecasts to members.
- To arrange for the triennial actuarial valuation of the Fund and send copies of the resulting report to Employers by the first anniversary of the valuation date.

2. Responsibilities

In addition, the responsibilities of the Fund in administering the Scheme are as follows:

- To appoint an actuary for the purposes of the triennial valuation of the Fund and to provide periodical actuarial advice when required.
- To appoint an Additional Voluntary Contributions provider.

- To comply with any orders or instructions issued by The Pensions Regulator or the Pensions Ombudsman. Where the order or instruction requires financial compensation or a fine to be paid from the Fund, or by any officer responsible for it, and it is due to the default, omission or otherwise negligent act of the Employer, the sum concerned shall be recharged to the Employer (see 7.1 above).

- To issue forms, newsletters, booklets and such other materials as are necessary in the administration of the Scheme, for members and use by Employers. Ensuring that the requirements of the Occupational Pension Scheme (Disclosure of Information) Regulations 1996 are met.

- To provide accurate, timely data to the Fund actuary for the purposes of the triennial actuarial valuation of the Fund and for Employer accounting reports (e.g. FRS17/IAS19).

- Where appropriate, to pay benefits based on additional service awarded by an Employer in accordance with the provisions of the Discretionary Regulations.

- To provide assistance to Employers in regard to the pension implications of outsourcing services and to deal with any related bulk transfers of pension rights.

- To comply with HMRC reporting requirements regarding pension benefits.

- To ensure that steps are taken at all times to pay benefits to appropriate beneficiaries only and to reduce the possibility of fraud.

- To ensure compliance with Data Protection legislation.

3. Discretions

The Fund has published policies on discretions afforded by the scheme regulations and related regulations. The policy statement has been supplied to Employers and is available from the Fund's website. Changes to that statement may be published from time to time and revised versions provided to Employers.

Appendix D – Contact Details

Fund Staff Contacts

An up to date list of Fund staff is available from our website.
Members of Scottish Borders Council's, HR Shared Services team administer the scheme for members of the Employer.

Contact Number: 01835 825052
E-mail Address: pensions@scotborders.gov.uk

Employer Staff Contacts

To help us ensure we communicate with the appropriate Employer representatives, the attached form (Appendix D1) should be completed confirming the individual's responsibility or interests and the type of communication they require. Additionally, you should indicate those who are designated as authorised signatory for pension forms.

Typical contact responsibility/interest and communications required, these may not apply to smaller employers with only one contact:

Responsibility/Interest

Regular	General contact for day to day enquiries
Payroll	Payroll related enquiries
HR	Human Resources/Personnel related enquiries
Auth Sign	Authorised signatory
Finance	Finance related enquiries
All	All of the above

Communications required:

Bulletin	Regular update on scheme
HR	Human Resources/Personnel related
Finance	Finance related
All	All of the above

Appendix D1 – Employer Contacts Form

Employer: Effective Date:

Contact Name	
Job Title	
Telephone Number	
E-mail Address	
Responsibility/Interest	
Communication Required	
Specimen Signature for Authorised Signatory	

Contact Name	
Job Title	
Telephone Number	
E-mail Address	
Responsibility/Interest	
Communication Required	
Specimen Signature for Authorised Signatory	

Contact Name	
Job Title	
Telephone Number	
E-mail Address	
Responsibility/Interest	
Communication Required	
Specimen Signature for Authorised Signatory	

Contact Name	
Job Title	
Telephone Number	
E-mail Address	
Responsibility/Interest	
Communication Required	
Specimen Signature for Authorised Signatory	

Contact Name	
Job Title	
Telephone Number	
E-mail Address	
Responsibility/Interest	
Communication Required	
Specimen Signature for Authorised Signatory	

Appendix E – Performance Measures

EMPLOYER PERFORMANCE MEASURES

The following will be the standard followed for reporting performance measures on an annual basis.

Service Standards

Standard – target completion 90%	Volume	%age Met	Average Time
New starts notification – within 20 working days			
Changes notified – within 20 working days			
Retirement info – at least 20 working days before			
Early leaver notification – within 20 working days			
Death in service notification – within 10 working days			
Query responses – within 10 working days			
Year-end queries – within 20 working days			

Contribution payments

Latest 12 months	Target Date	Date received
April		
May		
June		
July		
August		
September		
October		
November		
December		
January		
February		
March		

ADMINISTERING AUTHORITY PERFORMANCE MEASURES

Service Standards

Standard	**Volume**	**%age Met**
Transfer In Estimates supplied – within 20 working days		
Transfer Out Estimates supplied – within 20 working days		
Other Estimates supplied – within 10 working days		
Query responses – within 10 working days		

Other measures

Area	**Measure**	**Completed**
Employer Liaison Meetings	1 per annum	
Benefit Statements Issued	31 August	

Key Administration Tasks – latest period

Task	**Total received**	**Target**	**% Completed in target**
New entrants			
Early leavers			
Retirements			
Deaths in service			
Changes			
Estimates			

VERSION CONTROL TABLE

Version	Nature of Amendment	Date of Change	Author
2012 1.0	Creation of Pension Administration Strategy	27 April 2012	Ian Angus
2012 1.1	Changes following review by Anthea Green, Team Leader, HRSS	30 April 2012	Ian Angus
2012 1.2	Changes based on comments from David Robertson, Chief Financial Officer	1 May 2012	Ian Angus
2012 1.3	Changes based on comments from Lynn Mirley, Treasury & Capital Manager	10 May 2012	Ian Angus
2012 1.4	Changes based on comments from Ian Wilkie, Head of Legal & Democratic Services	31 May 2012	Ian Angus
2012 1.5	Changes following Pension Fund Sub-Committee 13 June 2012	5 July 2012	Ian Angus
2015 1.6	Amendments for 2014 regulations and Pension Board in place from 1 April 2015	23 July 2015	Ian Angus
2018 1.7	Amendments for 2018 regulations and name changes for Services	22 August 2018	Anthea Green

You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. Ian Angus can also give information on other language translations as well as providing additional copies.

Contact us at Ian Angus, HR Shared Services Manager, Old School Building, Newtown St Boswells, TD6 0SA 01835 826696, iangus@scotborders.gov.uk

This page is intentionally left blank

Consultation on the

Review of the Structure of the Scottish Local Government Pension Fund

Carried out by the Pensions Institute

on behalf of the Scottish Local Government Pension Scheme Advisory Board

June 2018

Contents

About the Pensions Institute

Hosted by Cass Business School at the University of London, the Pensions Institute (www.pensions-institute.org) is the first and only UK academic research centre focused entirely on pensions research. Our purpose is to serve as an essential forum for pensions data and research, with particular emphasis on the UK system.

About the Scheme Advisory Board

Established under the Public Service Pensions Act 2013, the Scheme Advisory Board's role is to provide advice to the Scottish Government on the desirability of changes to the design of the Scottish Local Government Pension Scheme and the implication of other policy issues.

Cabinet Secretary's foreword

I am delighted to support the launch of the Scottish Local Government Pension Scheme Advisory Board's consultation on a structural review of the Local Government Pension Scheme (LGPS) pension funds in Scotland.

LGPS fund authorities invest in a wide variety of projects including local housing and infrastructure, however investment in Scotland's infrastructure is only a small part of the investment strategy of the Scottish fund authorities. The Scottish Government is ambitious for greater investment by local government funds in Scotland's infrastructure.

There are currently excellent examples of fund authorities collaborating on infrastructure projects in Scotland. We look to LGPS fund authorities to improve their already positive impact on the economy thereby contributing further to sustainable economic growth, creating more jobs and supporting the delivery of key capital infrastructure needs in Scotland, such as transport projects and housing.

A key part of the Scheme Advisory Board's role is to provide advice about the effective and efficient administration and management of the Scheme. So I asked the board to investigate the collaboration between fund authorities to invest in Scottish infrastructure, whilst maintaining overall investment performance to ensure that the interests of LGPS members' are protected.

The Scheme Advisory Board commissioned reports from pension consultants Mercers and Iain Clacher of the University of Leeds on possible future structures for the funds. The reports highlight that the new governance arrangements require a greater focus on cost transparency and performance. The academic evidence on costs and fees also seems to support the premise that there are cost savings available with economies of scale for both the administration and investment of pension funds.

I welcome the Scheme Advisory Board's consultation, which provides four clear options for the future structure of pension funds in Scotland. I encourage you to participate fully in this important debate which could have a wide-ranging impact on the people of Scotland.

Derek Mackay MSP

Cabinet Secretary for Finance and the Constitution

Executive summary

This consultation seeks to establish the views of employers and employee representative groups on whether outcomes for the members and sponsors of the Scottish Local Government Pension Scheme (SLGPS) can be improved by altering the structure of the scheme.

The consultation asks these stakeholders to compare the advantages and disadvantages of the current scheme structure against three options that, by differing degrees, consolidate the functions of the scheme's 11 constituent funds by collaboration, pooling and merger.

The main question is whether the sustainability of the scheme, and thus members interests, can be improved by reducing the investment management costs of the system with the trade-off of potentially diminishing local governance and oversight.

Investment management costs are the single biggest line item of expenditure in the system and small reductions in fees can lead to significantly improved net investment performance for funds over the long run. But how do these quantitative gains compare to the qualitative losses of local control?

This central question also gives rise to subsidiary questions. Consolidation has the potential to improve the ability of funds to invest. Larger scale in funds could improve governance, the range of investments available to funds and the management of operating risks – each with the potential to enhance performance.

But at the same time, the roles of people working locally in funds could be diminished, with their responsibilities concentrated in a smaller set of larger funds. Changes to the current structure would generate set up costs and require careful implementation to ensure accountability was maintained.

The purpose of the consultation is to get feedback on four possible options, ranging from maintaining the *status quo* to full consolidation into one or more larger funds. Responses gathered in this consultation will be evaluated and presented to Scottish Government Ministers in 2019 for a decision on a future course of action.

Although this consultation asks questions about a potential future structure for the SLGPS, these questions were also relevant when designing the current system. This consultation asks whether the trade-off – between scaling up to reduce investment costs or retaining governance locally – inherent in the current system of 11 funds is the best interest of members and sponsors or should be revisited.

Introduction

This consultation invites employers and employee representative groups to give their views on how the Scottish Local Government Pension Scheme (SLGPS) should best be structured to serve its members and sponsors.

SLGPS is Scotland's largest pension scheme with currently more than 406,000 members who are employees, former employees and pensioners. It has members in local government, education, the police, the voluntary sector, environment agencies and private contractors. The scheme is composed of 11 individual funds with assets totalling around £42bn and liabilities to members of £55bn.[1] Each fund serves a different group of employer organisations, the largest fund is Strathclyde with £19.7bn in assets and 210,000 members; Orkney Islands is the smallest, with assets of £335m and 3,663 members.[2]

Research by the Scheme Advisory Board, a statutory organisation set up to advise SLGPS and the Scottish Government, shows that the scheme faces a number of significant challenges and, as a result, the current structure of the scheme with its 11 funds should be reviewed.

A selection of these challenges include: the deficit; investment management costs and their transparency; investment performance; volatile investment markets; low interest rates; a maturing scheme membership; and the consequences of implementing investment preferences in respect of certain assets, such as fossil fuels and infrastructure.

Based on this research, the Scheme Advisory Board has identified four options that compare the advantages and disadvantages of retaining the current structure of the scheme without change or, by degrees, consolidating the scheme's 11 constituent funds:

1. Retain the current structure with 11 funds.

2. Promote cooperation in investing and administration between the 11 funds.

3. Pool investments between the 11 funds.

4. Merge the 11 funds into one or more new funds.

The purpose of this consultation – requested by the Scottish Government Cabinet Secretary for Finance and Constitution, Derek Mackay MSP – is to ask employers and employee representative groups for their views on each of these options.

Responses gathered in this consultation will be evaluated by the Scheme Advisory Board and presented to Scottish Government Ministers in 2019 to inform any future course of action. As well as this consultation, Ministers will also take into consideration a

---

[1] The SLGPS also includes five additional funds including transport funds and the Scottish Homes Pension Fund which are managed by the 11 administering authorities.

[2] All figures dated 31 March 2017.

governance review of public sector pensions being undertaken by the Scottish Public Service Pensions Agency.

This consultation report contains detailed background on how the options were developed including web links to the original research reports; presents arguments for each option; and provides questions that LGPS employers and employee representative bodies should answer to present their views.

The consultation is being managed by Pensions Institute, an academic research organisation hosted by the University of London, on behalf of the Scheme Advisory Board.

How to participate

This consultation is open to LGPS employers and employee representative groups only. To have their views heard, these organisations should respond to the questions in the form accompanying this report and return it via email to the Pensions Institute at consultation@pensions-institute.org no later than Friday, 7 December 2018.

As it is not practical to engage with scheme members directly, respondents who are employee representative bodies are encouraged to canvass the views of their members in order to present their views to this consultation.

Employers who are also administering authorities are additionally invited to give their views from their perspective as authorities. The consultation will attempt to contact all employer members of the SLGPS but the 11 administering authorities should also encourage their admitted bodies to take part in the consultation.

This consultation is being conducted in electronic form only, so responses must be emailed; hard copy posted or delivered responses cannot be received. Any queries about the consultation should be addressed to Matthew Roy, Fellow, Pensions Institute at matthew.roy@pensions-institute.org.

Background to the consultation

1. A review of the structure of the SLGPS was agreed with stakeholders and the Scottish Government Ministers when the changes to the scheme and the new Scheme Advisory Board were introduced in 2015. The Scheme Advisory Board (SAB) proposed carrying out this review beginning in 2016.

2. SAB's proposal was approved by the Scottish Government Cabinet Secretary for Finance and Constitution.

3. Several studies were used to inform this review and make up the background to this consultation. These are summarised in Appendix 1.

4. In February 2017, SAB produced its own review report. This report is informed by the findings of research in Appendix 1 as well as a working party set up by the board comprising employers, trades unions and fund advisers. It also includes two new pieces of research commissioned by SAB from Mercer in 2016 and Iain Clacher at Leeds University Business School in 2017 and these are included as annexes to SAB's review report.

   The report can be found at SAB's website lgpsab.scot/consultation2018.

5. In summary, the report sets out four options for the future structure of the local government pension scheme in Scotland:

   1) Retain the current structure with 11 funds

   2) Promote cooperation in investing and administration between the 11 funds

   3) Pool investments between the 11 funds

   4) Merge the 11 funds into one or more new funds

6. The four options were presented to Scottish Government Ministers in May 2017. In January 2018, SAB received a letter from Derek Mackay MSP, Cabinet Secretary for Finance and the Constitution seeking a consultation with SLGPS employers and employee membership bodies on the four options.

7. The next section presents a summary of the arguments detailed in SAB's review report.

Summary arguments for and against the four options

8. The Scheme Advisory Board's 2017 report sets out four main options for the local government pension scheme and this consultation focuses on four criteria in relation to each option:

— Cost of investing: This is the biggest outlay by each fund in SLGPS and research suggest even small reductions in investing costs and, in particular, investment manager fees could have a significant impact on fund performance.

— Governance: Numerous studies show that improving governance produces significantly better outcomes over the long-term and that most pension funds in both the private and public sectors have room to improve in this area.

— Operating risks: Are believed to vary significantly among public and private sector pension funds depending on the effectiveness of the governance processes of each fund and the quality of the executive resources available to individual funds.

— Infrastructure investment: There is an increasing political desire that SLGPS funds be able to invest pension assets in infrastructure should they decide it to be in the interest of members and employers.

9. Below are summarised the advantages and disadvantages of each option in relation to these criteria and the questions asked in the consultation. The full arguments across a wider range of criteria can be found in SAB's review report. Detailed summaries of the arguments for each option are also presented in Appendix 2 of this report.

Option 1: Retain the current structure with 11 funds

10. The first option for the SLGPS is to do nothing and to maintain the status quo by retaining the current structure with 11 funds.

Cost of investing

11. Evaluating the costs of investing in the 11 funds is currently hindered by the funds' different approaches to reporting and a lack of transparency in investment fees. But from an investment perspective, maintaining the current structure is likely to mean that inefficiencies will remain across the SLGPS as most of the funds will not achieve the benefits of scale that have been documented across a number of countries including the UK. These benefits include improved bargaining power and reduced duplication of efforts in administration, governance, spending on advisors and fund management.

12. The consequence of this is that the scheme will continue to cost more per member for some employers than others. Over the long-run, such cost inefficiencies could be considerable and hence require higher contribution rates putting further pressure on local government and employer budgets.

Governance

13. The current structure of the SLGPS is complex and funds have responded by adopting a variety of different processes for managing investment mandates, investment fund performance and investment costs. As a whole, larger funds have greater resources and capacity to establish and manage these processes than smaller funds.

14. However, a potential advantage in maintaining the current structure would be to retain local oversight and strategy. This local connection may be more difficult to retain if centralised asset pools or merged funds were to be created, as are explored in the options below.

Operating risks

15. There is significant variation in the resources funds have to manage governance processes under the current structure. Smaller funds tend to have less executive support than larger funds. Funds run by only a few individuals may face 'key-person' risk where the incapacity or absence of a single individual hampers the operation of the fund.

Infrastructure

16. Funds have different capacities to invest in infrastructure under the current structure. Larger funds are better able to make investments in infrastructure projects, while small funds acting on their own may not have the resources or expertise to invest in these assets.

<u>Question 1:</u>

Please use the attached form when answering these questions and explain your responses.

a) Cost of investing:

- How well informed do you feel about the investment costs in your fund? What information do you rely on to specify and measure these?
- How well does the current system manage investment costs?
- How would you improve the measurement and management of investment costs in the current system?

b) Governance:

- How well informed do you feel about the governance of your fund? What information do you rely on to measure this?
- How well is the current system governed?
- How would you improve governance of the current system?

- How important is it to maintain a local connection with respect to oversight and strategy?
- How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?

c) Operating risks:

- How well informed do feel about the operating risks of your fund? What information do you rely on to specify and measure these?
- How well are operating risks managed in the current system?
- How would you improve the measurement and management of operating risks in the current system?

d) Infrastructure:

- How well informed do you feel about your fund's investments in infrastructure? What information do you rely on?
- How do you rate the current system's ability to invest in infrastructure?
- How would you increase investment in infrastructure in the current system?

e) Do you have any additional comments about this option?

Option 2: Promote cooperation in investing and administration between the 11 funds

17. The second option for the SLGPS is to retain the current structure with 11 funds but promote cooperation in investing and administration between different funds. Cooperation encompasses co-investment, and shared services, where funds agree to share functions in order to achieve cost savings through economies of scale.

Cost of investing

18. Cooperation between funds when hiring investing managers could lead to efficiency gains. One example of this is the investment collaboration between the Lothian and Falkirk funds. This agreement allowed Falkirk to leverage expertise and scale by jointly investing with the larger Lothian fund.

19. The Lothian-Falkirk example suggests that groups of funds could collaborate to lower costs by clubbing together when appointing managers to invest in particular asset classes. In this model, funds would invest in UK equities or other asset classes as one large block rather than as separate mandates across a number of funds.

20. But coordinating such joint procurement decisions in an informal environment may be challenging. Since any party is free to leave the arrangement, any cost savings may not be long lasting.

Governance

21. Under the cooperation option, the current structure of governance would continue. Investment mandates would be directed by the Pension Committee of each fund and each fund would retain local oversight and strategy. As such, cooperation between the funds would be limited in scope by the rules for investing followed by each Pension Committee.

22. Each collaboration arrangement would then require a new subordinate governance process. In the example of Lothian and Falkirk, the Pension Committees of each fund must agree to coordinate when they delegate investment mandates.

23. Although cooperation would require some sharing of control, and more complex governance, it would still retain some local oversight and strategy.

Operating risks

24. Promoting cooperation arrangements would not resolve issues that smaller funds may have with executive support. They would add new layers of complexity which must be managed. The need for funds to coordinate activities has the potential to reduce the effectiveness and responsiveness of the individual investment decisions of each fund, particularly if this slows down the investing process.

Infrastructure

25. In the Lothian-Falkirk example, both funds have been able to jointly invest substantial in infrastructure projects. But it is unclear how well collaboration agreements would scale to include more joint fund investors. Several funds may wish to club together to invest in large scale projects as each fund individually is likely to have only a small

allocation available to infrastructure as an asset class. It is unclear if funds could bear the transaction costs and resources this ‘clubbing together’ process would require or if it could be concluded swiftly enough.

Question 2:

Please use the attached form when answering these questions and explain your responses.

a) Cost of investing:

- What impact do you think promoting agreements between funds would have on investment costs?
- What would be the positive impacts?
- What would be the negative impacts?

b) Governance:

- What impact do you think promoting agreements between funds would have on governance?
- What would be the positive impacts?
- What would be the negative impacts?

c) Operating risks:

- What impact do you think promoting agreements between funds would have on operating risks?
- What would be the positive impacts?
- What would be the negative impacts?

d) Infrastructure:

- What impact do you think promoting agreements between funds would have on funds’ ability to invest in infrastructure?
- What would be the positive impacts?
- What would be the negative impacts?

e) Do you have any additional comments about this option?

Option 3: Pool investments between the 11 funds

26. The third option covers asset pooling where the assets of distinct pension schemes are consolidated into one or more asset pools to be managed centrally on behalf of the different schemes. Schemes retain their governance, administration and back office functions and continue to appoint and manage many of their advisers. This process would be analogous to the pooling of LGPS assets that is ongoing in England and Wales.

27. Asset pooling would be a significant shift to the way in which the SLGPS manages its investments. From an investment perspective, if there were to be a single aggregated pool, it would have circa £42bn of assets under management more than double the size of the largest fund currently, Strathclyde at £19.7bn in assets.

28. Although funds would be pooled, assets and liabilities would still be allocated by the employer in the same way as the current arrangements. This ensures that employers would still be liable for the pension obligations that they have accrued, for any deficit that they are liable for currently, and for any new benefits that are promised.

Cost of investing

29. Asset pooling has the potential to generate significant cost savings from scale over the long-term. For instance, the larger scale of asset pools could enable the majority of the investment activities of funds participating in each pool to be brought in house, which is likely to create significant cost efficiencies over time as well as allowing for a more sophisticated and dynamic investment strategy.

30. A significant challenge in successfully pooling assets is achieving scale to cover set-up costs, ongoing operating expenses and governance costs. In the short-term, pooling would generate large initial transitional and set up costs, potentially including the requirement to seek FCA authorisation for the new asset pools.

Governance

31. From a governance perspective, under asset pooling each fund's Pensions Committee would likely retain responsibility for determining the asset allocation for their investments, making funding decisions and ensuring funds were managed in accordance with applicable laws and regulations. However, the day-to-day management of the investments would be delegated to the pool.

32. Each fund would also retain its Pension Board as stipulated in The Public Service Pensions Act 2013, with its existing employer and employee representation, as well as its role to provide advice on the administration and management of the pool.

Operating risks

33. Pooling assets would significantly boost the executive resources available to manage governance process related to day-to-day investing. But investment management risks would become concentrated in the new asset pools. It would be critical to establish clear lines of responsibility to ensure there is accountability for decisions made when managing the pool and to retain local oversight and strategy.

Infrastructure

34. By grouping investments together under single mandates, pooling is expected to significantly boost the capability of the SLGPS to invest in infrastructure. Combined in pools, the buying power of each individual fund's allocation to infrastructure could be exercised collectively, in a coordinated way.

Question 3

Please use the attached form when answering these questions and explain your responses.

a) Cost of investing:

- What impact do you think pooling investments between funds would have on the cost of investing?
- What would be the positive impacts?
- What would be the negative impacts?
- If asset pooling were possible, under what circumstances should a fund consider joining an asset pool?
- Under which circumstances should the SLGPS consider directing funds to pool?

b) Governance:

- What impact do you think pooling investments between funds would have on governance?
- What would be the positive impacts?
- What would be the negative impacts?

c) Operating risks:

- What impact do you think pooling investments between funds would have on operating risks?
- What would be the positive impacts?
- What would be the negative impacts?

d) Infrastructure:

- What impact do you think pooling investments between funds would have on funds' ability to invest in infrastructure?
- What would be the positive impacts?
- What would be the negative impacts?

e) Do you have any additional comments about this option?

Option 4: Merge the funds into one or more new funds

35. The fourth scenario is for funds in the SLGPS to merge, with assets, liabilities and administrative functions being managed by one or more larger funds.

36. Merging pension funds poses a number of challenges. Although funds merge, their assets and liabilities still have to be allocated by the employer, as employers would remain liable for the pension obligations that they have accrued, for any deficit that they are liable for currently, and for any new benefits that are promised.

Cost of investing

37. Fund mergers have the potential to generate significant cost savings from scale over the long-term in the same way that asset pooling does. For instance, the larger scale of funds could enable the majority of the investment activities of merged funds to be brought in-house, which could create significant cost efficiencies over time as well as allowing for a more sophisticated and dynamic investment strategy.

38. Fund mergers may provide additional improvements to the cost of investing over and above pooling. As well as day-to-day investment management, other back office functions would also be combined to lower costs. Larger scale asset pools may also make available additional investment risk management strategies, such as interest rate hedging.

39. In the short-term, merging would generate large initial transitional and set-up costs.

Governance

40. The full merger of SLGPS funds would likely have the most far-reaching consequences for governance. Governance would likely no longer be a local government function and could be the responsibility of one or more central government bodies. Although there would be local government representation on the Pensions Boards of the merged funds, the treasury function of the local authority is no longer likely to have direct involvement in any pension fund matters.

41. The dual board-committee structure could persist or be replaced by different arrangements such as a lead authority or a joint board.

Risk management

42. Mergers, like the asset pooling option, would significantly boost the executive resources available to manage governance process related to day-to-day investing, but additionally bring more executive support to bear in merged back office and administrative support functions.

43. As in asset pooling, it would be critical to establish clear lines of responsibility to ensure there is accountability for decisions made when managing merged funds.

Infrastructure

44. By grouping investments together under single mandates, mergers, like pooling are expected to significantly boost the capability of the SLGPS to invest in infrastructure.

Combined in merged funds, the buying power of each individual fund's allocation to infrastructure could be exercised collectively, in a coordinated way.

Question 4

Please use the attached form when answering these questions and explain your responses.

a) Cost of investing:

- What impact do you think mergers between funds would have on the cost of investing?
- What would be the positive impacts?
- What would be the negative impacts?
- If merging were possible, under what circumstances should a fund consider a merger?
- Under what circumstances should the SLGPS consider directing funds to merge?

b) Governance:

- What impact do you think mergers between funds would have on governance?
- What would be the positive impacts?
- What would be the negative impacts?

c) Operating risks:

- What impact do you think mergers between funds would have on operating risks?
- What would be the positive impacts?
- What would be the negative impacts?

d) Infrastructure:

- What impact do you think mergers between funds would have on funds' ability to invest in infrastructure?
- What would be the positive impacts?
- What would be the negative impacts?

e) Do you have any additional comments about this option?

Question 5

Please use the attached form when answering these questions and explain your responses.

a) Which option does your organisation prefer? Please explain your preference.

b) What other options should be considered for the future structure of the LGPS?

c) What would be the advantages and disadvantages of these other option for funds' investment costs, governance, operating risks and ability to invest in infrastructure?

d) Are there any other comments you would like to make?

Appendix 1: Reports of previous pension scheme reviews

Deloitte report

A copy of the Deloitte report can be found SAB's website lgpsab.scot/consultation2018.

In 2011, Deloitte presented research on the merits of combining the investment and administration functions of the SLGPS. This research was conducted as part of a Pathfinder Project to identify potential cost savings and operational efficiencies in SLGPS by adopting shared services. Participants in the research included the Improvement Service, Scottish Government, Convention of Scottish Local Authorities (COSLA), the 11 funds and the Scottish Public Pensions Agency.

The 2011 report considered a number of models including retaining the current structure and merging into one, two or three larger host funds. While Deloitte identified a number of key risks in the current structure, they concluded that the savings in investment management fees would not be significant enough to justify, in cost terms alone, merging funds. They reached a similar conclusion in relation to an improvement in investment performance. They did recommend less active investment management and pointed to the benefits, particularly for small and medium sized schemes, of shared technical advice.

In relation to administrative costs, the report found that costs per member in Scotland compared favourably with funds in England and Wales. However, based on the experience of shared services between Cumbria and Lancashire, Deloitte recommended further consideration of a single operating model and a common administration system – rather than formal administrative mergers.

APG report

A copy of the APG review can be found at SAB's website lgpsab.scot/consultation2018.

In light of increasing awareness about investment fees and performance, UNISON commissioned the Dutch pension group, APG, to undertake a similar review of LGPS pension funds across the UK, including Scotland. APG evaluated data on 101 funds over 2001–09 and modelled the impact of fund mergers.

APG concluded that investment expenses and administration costs decline when the size of fund increases and that larger funds consistently achieved higher investment returns. They also drew upon international studies that show substantial positive economies of scale in asset management.

APG's simulation for one fund in Scotland indicated average annual savings in investment management costs of £7m. They also concluded that improved investment performance could have led to £772m of additional assets for Scottish funds.

Audit Scotland report

A copy of the Audit Scotland report can be found at SAB's website:
lgpsab.scot/consultation2018
or the Audit Scotland website:
www.audit-scotland.gov.uk/report/the-cost-of-public-sector-pensions-in-scotland

In 2011, Audit Scotland reported on the cost of public sector pensions in Scotland. The focus of this review was on the costs of benefits and associated contributions. Audit Scotland summarised the advantages and disadvantages, which essentially come down to economies of scale and expertise as against transition costs and the impact on local governance.

Cost transparency code and FCA market study

Information about the cost transparency code for the local government pension scheme in England and Wales can be found on the scheme's website:
lgpsboard.org/index.php/structure-reform/cost-transparency

Information about the FCA's market study into asset management can be found at the authority's website:
www.fca.org.uk/publications/market-studies/asset-management-market-study%20

In 2015, the Financial Conduct Authority (FCA) launched an asset management market study to understand how asset managers compete to deliver value to both retail and institutional investors. The FCA found weak price competition with evidence of sustained, high profits over a number of years.

The local government pension scheme in England and Wales launched a Code of Transparency to improve investment fee transparency and consistency. The voluntary code sets standards for reporting on fees paid to asset managers and was adopted by SLGPS in 2016.

Appendix 2: Overview of advantages and disadvantages for the four options

Criteria	OPTION 1 Retain the current structure with 11 funds	OPTION 2: Promote cooperation in investing & administration between the 11 funds	OPTION 3: Pool investments between the 11 funds	OPTION 4: Merge the funds into one or more new funds
GOVERNANCE	**PROS** Maintains local decision making and connection with respect to oversight and strategy.	**PROS**	**PROS** There is not, at least at a high level, an issue of localism vs centralisation that emerges from merging/pooling; it is simply a question of investing in the most cost effective way to secure member benefits. Professionalise decision making and governance. Some representation of local authorities on a Pensions Committee, which would set broad asset allocation, risk budgets, and risk-adjusted performance criteria for the investment of the assets. Funds may be more focused on the performance and accountability of an investment pool and it is likely that they would exert a high degree of scrutiny on the performance of the pooled assets. Additional gains from better risk-management functions under the ethos that good governance should drive outcomes and not just wrap round a predetermined solution or structure. More arms-length from administering and reduced conflicts of interest.	**PROS** Reduces number of Pension Boards. A fund as large as a pooled Scottish LGPS would be able to attract and recruit the best people.

Criteria	OPTION 1 Retain the current structure with 11 funds	OPTION 2: Promote cooperation in investing & administration between the 11 funds	OPTION 3: Pool investments between the 11 funds	OPTION 4: Merge the funds into one or more new funds
	CONS Potential conflicts between Fund and Administering Authority e.g. in multi-employer fund, setting contribution rates. Duplication across funds in terms of administrative, governance, advisory, and fund management costs, and lack of scale in most of the Scottish LGPS funds. Large number of stakeholders and decision makers including committees and pension boards. Specialist staff recruitment (especially for investment) can be difficult due to terms and conditions of councils and/or for more rural funds. Lack of internal resource and staff in smaller funds have other duties to perform that can be impacted by broader council developments.	**CONS**	**CONS** Increase in consolidation of governance thus reducing local governance. A significant shift towards a more central structure such as asset pooling could remove existing functions such as trustees etc. Such change will take time and cost money, both of these factors have to be accepted and the costs and benefits of the envisaged structure would have to be clear and accepted by a wide range of stakeholders. Moreover, the gains to any long-term strategic shift in the operation of the Scottish LGPS are likely to emerge over a number of years rather than immediately or in the short-term.	**CONS** Governance would no longer be a local government function and would be the responsibility of a quango. Potential disconnect between the employer and the scheme leading to lower local engagement.

Criteria	OPTION 1 Retain the current structure with 11 funds	OPTION 2: Promote cooperation in investing & administration between the 11 funds	OPTION 3: Pool investments between the 11 funds	OPTION 4: Merge the funds into one or more new funds
INVESTMENT	**PROS** Bespoke investment strategy and implementation for each fund. Potential to collectively negotiate with existing managers to reduce fees.	**PROS** Joint procurement of investment managers or other services could lead to some efficiency gains. Potential to leverage some of the internal expertise and scale within the larger funds. Some cost efficiencies could be gained if broad mandates e.g. UK passive equities were to be invested as one large block rather than as separate mandates across a number of funds	**PROS** Significant cost savings resulting from scale. Ability to move towards greater internal management. Professionalisation of investment – FCA authorisation likely to be required. Resolves MIFID II issues. Enable the in-housing of the majority of the investment activities of the fund, which is likely to create significant cost efficiencies as well as allowing for a more dynamic investment strategy. -Increased employment as a result. Ability to invest in new asset classes/opportunities. A more transparent and uniform governance model with potential to improve returns. Collective proactive stewardship opportunities to capture the 'engagement premium' which could add up to 2 to 4% in the first year to returns. Smaller funds gain access to new investment opportunities.	**PROS** Likely that significant cost savings could be generated if there was to be a significant scaling up of pension fund assets as this increases the bargaining power of the SLGPS. Increased sustainability of SLGPS

Criteria	OPTION 1 Retain the current structure with 11 funds	OPTION 2: Promote cooperation in investing & administration between the 11 funds	OPTION 3: Pool investments between the 11 funds	OPTION 4: Merge the funds into one or more new funds
	CONS Inefficiencies will persist and not allowing benefits of scale thus risking future sustainability. Investment mandates, performance targets, and an understanding of costs and fees are unlikely to be optimal. While likely that improved disclosure via better data collection (now underway) will help improve this situation in the coming years, it does not necessarily shift the dynamic between funds and fund managers, as there is only a small increase in bargaining power. Pension funds, in all likelihood, would remain price takers. Limited options for bespoke employer investment strategies. Smaller funds lack influence unable to take an active role as a shareholder. Smaller schemes face key-person risks. MIFID II, and FCA classification of local authorities, could have major impact on investment options available.	**CONS** Relies on Pension Committees and officers being more coordinated / or compromising. Potentially a slow process. Sustainability risk e.g. if one fund decides to terminate agreement. Potential issues relating to unauthorised investment advice due to lack of FCA authorisation. Opportunity of gains limited by virtue of extant governance structures. Does not resolve MIFID II issues. Potential for smaller funds gaining access to new opportunities.	**CONS** Complexity and costs of establishing FCA authorised pool. Could be time consuming to establish. Lose local connection with funds. E&W models untested as yet so there is no track record to assess benefits.	**CONS**

Criteria	OPTION 1 Retain the current structure with 11 funds	OPTION 2: Promote cooperation in investing & administration between the 11 funds	OPTION 3: Pool investments between the 11 funds	OPTION 4: Merge the funds into one or more new funds
FUNDING	**PROS**	**PROS** Greater consistencies of funding approach, depending on service to be shared. Potential for consistent approach to employer covenant and offering different funding options including offering different investment strategies.	**PROS** Funds retain funding decisions. May provide wider range of options for different investment/funding strategies.	**PROS** Employer liabilities remain identifiable thus avoiding concerns with regard to cross-subsidy or netting of gain/losses at the time of merging funds. May provide wider range of options for different investment/funding strategies. Consistent funding approach within each new fund. (See funding challenges section in Annex 5). This could include the approach to employer covenants and the potential to offer different investment/funding options. Resolves the funding inconsistencies and the issue of risk of cessation faced by employers who are admitted to more than one fund. May be an opportunity to separate the liabilities of certain employers from others and put in place different funding arrangements, potentially reducing the exposure of the other employers in the funds. For example, certain groups of employers could be grouped for funding purposes and bespoke admission agreements/guarantees put in place e.g. third sector/charities or colleges. Improves long term sustainability of the SSLGPS.

Criteria	OPTION 1 Retain the current structure with 11 funds	OPTION 2: Promote cooperation in investing & administration between the 11 funds	OPTION 3: Pool investments between the 11 funds	OPTION 4: Merge the funds into one or more new funds
FUNDING	**CONS** Difficult to see the funding position of the Scottish LGPS as a whole. Employers who are admitted to more than one fund have inconsistent funding approaches and risk of triggering cessations. Duplication/inconsistent approach to employer covenant. Limited options for bespoke employer funding strategies.	**CONS** Limited opportunity for improvement and the cons associated with the status quo option would remain.	**CONS** Funds retain funding decisions and inconsistencies persist.	**CONS** Potential lack of customisation of assumptions for different employers.
PENSION ADMINISTRATION	**PROS** More local/ bespoke service.	**PROS** (As per merging funds, depending on the collaboration).	**PROS**	**PROS** Improved economies of scale. Consistent service for all members and employers. Removes duplication. IT system rationalisation and standardisation.

Criteria	OPTION 1 Retain the current structure with 11 funds	OPTION 2: Promote cooperation in investing & administration between the 11 funds	OPTION 3: Pool investments between the 11 funds	OPTION 4: Merge the funds into one or more new funds
	CONS Costs in some schemes will remain higher than they need to be. Inefficiencies in data submission for employers admitted to more than one fund. Inconsistent service for members, particularly evident where employers are admitted to more than one fund. Duplication of effort. Key-person risks.	**CONS** (As per merging funds, depending on the collaboration).	**CONS** As per status quo.	**CONS** Potential loss of local service / local jobs.
INFRASTRUCTURE (note that Investment costs mentioned above generally apply)	**PROS** Local funds retain decision making on the type of infrastructure investment.	**PROS** Potential to leverage expertise within existing funds.	**PROS** Scale facilitates direct and co-investments in large infrastructure projects and at lower cost.	**PROS**
	CONS Smaller funds don't have expertise to implement. Safeguards need to be put in place to prevent governmental or local issues driving investment to projects where there is no financial return to the pension fund.	**CONS** Safeguards need to be put in place to prevent governmental or local issues driving investment to projects where there is no financial return to the pension fund.	**CONS**	

Option1	Advantages	Disadvantages
Retain Current Fund Structure	System currently works – it is not clear what problem a review of the current structure is actually trying to address. Good funding levels across Scotland as evidenced by Audit Scotland Investment returns consistently positive over the short, medium and long term. For example 9 out of the last 10 years have seen positive returns for Scottish Borders Council in excess of benchmark. Sound governance arrangements nationally in place as evidenced by Audit Scotland reports. Pension Boards, while relatively new, have given an added additional level of scrutiny involving employer and employee. The current structure supports local decision making with regard to investment strategy and asset allocation with a key role for elected members in the governance. Contribution rates remain low and stable with an 18% pool rate in Scottish Borders providing a cost effective pension scheme for employers. Membership levels remain high (overall %age?) as a proportion of the work force have been boosted auto enrollment indicating that members value their pension and trust that the current arrangements will provide for them in retirement.	There is a risk that smaller funds are too reliant on key individuals to manage the pension fund. The costs of maintaining 11 pensions systems could be reduced with greater collaboration or one contract with Heywoods who it is understood provide systems to all funds. There is a perception that the current arrangements are costly both in terms of fees and administration there is however little evidence to support this view. The important point is that performance should be assessed net of fees and increasingly investment managers such as Baillie Gifford are offering a consistent fees for all LGPS clients. The important point being fees paid are proportionate to the risk taken in delivering investment returns and **net** returns drive out peformance. The desire to see LGPS funds investing in infrastructure is a well-established political objective; however, it must be recognized that fund assets are separate from council funds and exist to pay for liabilities. Any decision to invest in infrastructure need to be based on an objective assessment of risk and reward to the pension fund as well as the cost and benefit of such investment to local communities. One cannot be assessed and achieved without an understanding of the

	Scottish Borders Fund is well diversified across a range of asset classes, providing sound investment returns and sustained improvements in the funding level over time. For example in 2011 the funding level was 98%, in 2014 101%, in 2017 114%. The surplus funding is now enabling a review of the strategic asset allocation to move from equities to less volatile asset classes. Appropriate expertise is maintained linked to the well-established sharing of good practice across the 11 Funds. The status quo avoids the need for expensive restructuring and ensures the returns delivered by investment can be retained by Funds rather than being spent on costly transition costs. There is no evidence that restructuring in England and Wales has, or will, deliver any benefits when compared to previous arrangements. It is concerning that the evidence based used for pooling in England and Wales is so patchy and unrelated to UK pension funds. Any move to restructure the current LGPS must be based on sound empirical evidence and must deliver tangible improvement for both large and smaller funds when compared to the 11 fund structure. Collaboration is already working and is increasing for example. Falkirk and Lothian have	other and there needs to be an acceptance that meeting the policy objective of having funds invest in local infrastructure must result with the risk of higher project costs for Local Authorities.

	successfully collaborated for many years. Scottish Borders has successfully collaborated since 2016 with Lothian Pension fund on infrastructure investments and it is understood Fife Council are actively pursuing collaboration with Lothian, avoiding expensive restructuring and allowing cost effective access to infrastructure markets. One advantage of the current structure is that smaller funds are able and willing to access investment opportunities which would not be of interest to the larger funds or pools. Larger pools due to scale may be unable to take advantage of these niche opportunities to realign their strategic asset allocation quickly.	
Option 2	**Advantages**	**Disadvantages**
Promote Cooperation in Investing and administration	Cooperation would allow bets practice using existing structures and systems to develop over time. Risk to current funding levels would be minimized. The sound investment returns delivered by funds over many years would not be compromised. Nor would any differences which currently exist between funds for example funding levels and rates of employer contribution require to be addressed. (This could of course be avoided through segregation of funds but would require enhanced levels of administration and reconciliation.)	The current level of collaboration is low and the pace of change needs to be enhanced. May be a perceived loss of influence by Councilors in favor of delegation to officers. Need to ensure there is not an increased administrative under this option, e.g. reporting what collaboration has actually been undertaken. Risk that under a collaborative investment model inappropriate resilience is placed upon the work of others and the necessary diligence on behalf of individual funds does not take place with sufficient rigor. The effectiveness of any diligence process is reliant upon funds

	Existing governance arrangements would not be compromised. Links to local accountability would be maintained and the recent development to establish Pension Fund Boards would be allowed to reach its full potential. There would be no need to develop new asset allocation strategies for segregated funds linking risk appetite, required return and varying funding levels. Collaboration would allow the continued diversification of funds and would ensure that strategic asset allocations remained aligned to funding levels reflecting the different positions across 11 funds, none of which are currently in an adverse funding position. Further enhances current models of collaboration. This could however be delivered in a more structured and consistent manner if the benefits of collaboration were to be accepted and promoted. Collaboration will allow the retention of local expertise in the Finance and HR function providing depth and resilience across Scotland, particularly in smaller authorities, which would otherwise be lost. It should be recognized that expertise in pensions and investment, an understanding of financial markets and pension benefits provides significant advantages and support to the wider local	having a clear understanding of the key features and risks associated with investment products.

	authority. This would be lost under a formal restructuring proposal but could be retained under a collaboration model. This point is linked strongly to concerns over key person risk should restructuring occur allowing the retention of local experience to advise local councilors and board members appropriately. Ensures that value would not be lost through adverse timing of sales and the repurchase of assets as funds restructure. Risk under this option is therefore avoided when compared to formal restructuring.	
Option3	**Advantages**	**Disadvantages**
Investment Pooling	Current governance structures would remain in places avoiding costly restructuring and preserving recent changes made to enhance governance through the establishment of Boards. Perception that pooling would save costs with regard to manager fees. Would retain local expertise and staff to assist. Would allow funds to maintain their current asset allocation strategies in response to current funding position and risk appetite	Added layer of bureaucracy would be required under this option. Staff would be required to run the new pools at potentially significant cost if staffing arrangements and grades sit out with LGPS pay structures. There is no evidence that the pooling arrangements in England and Wales have delivered any cost benefits or improvements in governance. Tangible evidence is scarce however anecdotal evidence of pooling so far seems to indicate that the process has been problematic with concerns over loss of local accountability and governance resulting in disagreement e.g. the London CIV

		The costs of pooling may be significant and will require substantial professional advice from pension fund managers, investment consultants and actuaries. The drive to establish larger pools may perversely have the effect of increasing fee costs in the longer term as fewer remaining providers are able to exercise their market dominance to increase fees with little risk of losing business. The timing of the financial transitions required to establish pools may be problematic if disinvestments are executed at a time when markets are volatile. This will introduce risk and unnecessary cost. Increasing cost may perversely cause pools to invest in higher risk higher yield assets to recover the ground lost through timing losses and to recover establishment/ transition costs. Pooling would result in a dilution of local expertise and knowledge potentially increasing risk to the smaller councils where staff often perform a wider role with respect to the financial management of the authority. Pooling may thereby reduce opportunities for elected members to access financial advice and reduce expertise at a local level. Pooling will not promote collaboration and expertise across the wider funds' activities.

		Pooling will offer no advantages for pension fund administration. Larger pools may be unwilling or unable due to scale to access smaller niche investment opportunities, for example recently the Borders has invested further in the M&G Alpha Opportunities Bond Fund which is closed to new members.
Option 4	**Advantages**	**Disadvantages**
Full Merger	The consultation document notes significant cost savings as a potential advantage of this option. There is however little UK and clearly no Scottish evidence for this assertion. Both investment advisors and investment managers have noted that the effects of pooling in England and Wales are already providing benefits for the Scottish LGPS through lower fees while to date the costs of restructure have been avoided. Would eliminate key person risk for smaller pension funds. It is unclear how merger would assist with the process of investment in infrastructure. If such investment is identified as being the correct course of action for funds as part of their strategy this should be pursued. Collaboration without restructure provides an equally valid route to access infrastructure at poentially much lower cost. Could be savings from back office functions. This may however have an adverse impact	Proposal in untried and the risks of merger are not fully understood. This feels like a step in the dark for unquantified benefits It is not clear what effect this option would have on funding levels, which could potentially change for individual employers under a fully merged structure. Merger would require a new asset allocation strategy for the new funds linked to funding levels and a new combined actuarial valuation. New governance arrangements would be required and this would incur additional costs to transition to the new arrangements. TUPE transfer would apply to staff who spend a significant element of their time on pensions matters. There are potential redundancy costs to be met by pension funds The move to formal restructure would sever links to local decision making with regard to investment strategy and asset

	on council's where staff resources are currently shared between the Fund and the Council	allocation removing a key role for elected members in the governance of pension funds. The effect on funds contribution is not known. It should be noted however that some of the smaller funds have the lowest contribution rates at present indicating a high degree of efficiency in terms of cost and investment returns. The funds in in rural areas also have the some of the highest longevity for fund members. The effect of merger on Fund diversification is not known. There is a risk that investment in assets with higher risk profiles over many years may be required to compensate for the costs of merger. Appropriate expertise will be lost from individual councils with a knock on effect on the wider financial expertise available to the council with a potentially detrimental impact. Full Merger is likely to require expensive restructuring. There is no evidence that restructuring in England and Wales has, or will, deliver any tangible benefits when compared to previous arrangements. It is concerning that the evidence based used for pooling in England and Wales is so patchy and unrelated to UK pension funds. Any move to restructure the current LGPS must be based on sound empirical evidence and must deliver tangible improvement for both large and

		smaller funds when compared to the current structure. One disadvantage of fewer larger funds may be an inability or unwillingness to access investment opportunities which would be of interest to smaller funds or pools. The process of transition may unsettle the membership encouraging transfers out of the fund and discourage new entrants.

This page is intentionally left blank

STRATEGIC INVESTMENT REVIEW

Report by Chief Financial Officer

JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION FUND BOARD

13 September 2018

1 PURPOSE AND SUMMARY

1.1 **The report provides the Committee and Board with an update on the outcome of the Strategic Investment Review and presents the resulting recommendations for the revised asset allocation**.

1.2 The Investment strategy is a key to ensuring assets continue to grow to meet the long term liabilities of the fund and that as far as possible the contribution rates from employers remain stable.

1.3 A review of the current strategy has been undertaken by KMPG in consultation with officers and the findings are detailed in Appendix 1. Para 4.3 details the recommended revised asset allocation.

2 RECOMMENDATIONS

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

(a) Agree the investment strategy as detailed in para 4.3;

(b) Delegate authority to the Chief Financial Officer, in consultation with the Chair of the Pension Fund Committee and based on the advice of the Investment Advisor to implement the outcome of a review of the number of equity managers; and

(c) Delegate authority to the Chief Financial Officer, in consultation with the Chair of the Pension Fund Committee, and based on advice of the Investment Advisor to implement the revised investment strategy.

3 BACKGROUND

3.1 The Pension Fund is required by the Local Government Pension Scheme (LGPS) Regulations to have an up-to-date Statement of Investment Principles (SIP). A key part of the SIP is the strategic asset allocation which sets the allocation of investments across the different asset classes.

3.2 The Funds primary aim is "To provide for members' pension and lump sum benefits on their retirement or for their dependants' benefits on death before or after retirement, on a defined benefits basis". To meet this aim the Fund must ensure it sets levels of contributions that will build up a fund of assets sufficient to meet all future benefit payments.

3.3 The Fund while setting the contributions rates aims to ensure the rates payable by employers are as stable as possible. To reduce the volatility of rates the Fund must ensure there is stability and the required level of returns from the investments.

3.4 The last review of the strategic asset allocation was undertaken in December 2016 following the 2014 tri-annual revaluation and the appointment of KPMG as Investment Advisor. The outcome of this was incorporated into the current SIP and good progress has been made to implement it.

3.5 The results of the triennial valuation on 31 March 2017 have seen the funding position of the Fund increase from 101% to 114%. It was agreed in the Business Plan on 16 June 2018 in line with good practice to undertake a health check of the current SIP following these results.

4 STRATEGIC REVIEW

4.1 KPMG has undertaken a health check of the current investments within the fund and found the Fund has continued to perform well over the last 5 years with returns above the required levels. The fund however, due to the strong performance of equities, still remains exposed to the risks inherent in investing in both Global and UK equity markets. The markets have performed well over the period, however equities have no direct link to the increasing liabilities arising through inflation, interest rates and changing member demographics and the review therefore recommends a reduction in the funds exposure to this asset class.

4.2 The fund is well diversified across a range of both public and private markets and the new assets groups introduced in the last two years have seen more of the fund's investments now being held in inflation linked assets with lower risk profiles. With the improvement in the funding positon and the recent strong market performance of equities there is an opportunities for the fund to further reduce its equity exposure risk and to move to longer term more illiquid assets which are characterised by lower inherent volatility and which provide an element of inflation linkage.

4.3 The new strategy recommends an investment in infrastructure debt which it is felt will help to provide greater diversification, reduce the funds exposure to equity risk and provide a greater element of inflation protection. Appendix 1 details the full findings of the review and the table below details the resulting recommended changes to the asset allocation:

Asset Group	Current Position	Recommend Position	Move-ment
Equities	47.5%	40.0%	(7.5%)
Diversified Alternatives	7.5%	7.5%	-
Balance Property	5%	5.0%	-
Long Lease Property	10.0%	10.0%	-
Direct lending	10.0%	10.0%	-
Infrastructure (including Junior Infrastructure debt)	5.0%	7.5%	2.5%
Index Linked Gilts	5.0%	5.0%	-
Diversified Credit	10.0%	10.0%	-
Infrastructure Debt (senior)		5.0%	5.0%

4.4 The transition to the recommended revised strategy will take time and require disinvestment of some funds and the establishment of some new funds. It is proposed this is done on a phased based as detailed in appendix 1, using existing managers where possible to minimise the cost of transition. The timescales for moving to the new strategy is estimated at this point to be around 12-18 months and any revision to this timescale will be reported to committee.

4.5 With the recommended reduction of equities it is proposed a review is undertaken regarding the number of equity managers the fund current invests with. This will be undertaken prior to the withdrawal of funds from equities.

5 IMPLICATIONS

5.1 Financial

(a) The revised asset allocation will require the establishment of new portfolios within the Fund. To minimise the costs of procurement Officers in conjunction with the Investment Advisor will investigate the use of existing Managers where possible.

(b) The recommended additional allocations to Infrastructure Debt will not incur stamp duty or large one off fees for implementation. The review of equity managers will include the effect on the fees and look to ensure best value is achieved with the best blend and number of managers.

5.2 Risk and Mitigations

(a) The Fund is becoming more mature as the number of deferred and retired members now exceeds those currently contributing. This has resulted in a negative fund cashflow as the monthly payments to Pensioners are now greater than the contributions collected through payroll. The Fund therefore needs to generate more liquid cash in order to pay pensioners and the current arrangements, whereby dividends are directly reinvested back into the portfolios. The mix of

investments required to meet the funds cashflow obligations requires to be kept under review to ensure the Fund generates the monthly cash income returned the Fund to allow payment of pensioners.

(b) The terms of the scheme allow for annual inflation linked increases in pension payments. There is a risk that this may result in increased liabilities which outstrip any the future growth in investments. To mitigate this risk the investments require to be diversified into assets which match the liability growth rate.

(c) The uncertainty associated with "Brexit" continues to impact on the markets as the details of the separation from the EU continue to emerge. This uncertainty is likely to have an impact on the markets for some time to come.

(d) In line with the Corporate risk management approach the Pension Fund maintains a full risk register which is fully reviewed on an annual basis and reports are submitted to the Joint Pension Fund Committee and Board on a quarterly basis updates on ongoing mitigation actions. Any new risks identified are added to the risk register on an ongoing basis.

5.3 **Equalities**

An Equalities Impact Assessment has been carried out on this proposal and it is anticipated that there are no adverse equality implications.

5.4 **Acting Sustainably**

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

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 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 have been incorporated into the report.

Approved by

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

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Pension & Investment Manager, 01835 825249

Background Papers
Previous Minute Reference: Pension Fund Committee and Pension Fund Board, 16 June 2016

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

Contact us at Contact us at: Pension & Investment Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825249 Fax 01835 825166.
email: treasuryteam@scotborders.gov.uk

This page is intentionally left blank

KPMG

Scottish Borders Council Pension Fund

Investment Strategy Health Check

–

August 2018

Contents

The contacts at KPMG in connection with this report are:

David O'Hara
Partner
Investment Advisory
Tel: 0141 300 5533

Andrew Singh
Executive Consultant
Investment Advisory
Tel: 0131 451 7749

Tony Hodgson
Consultant
Investment Advisory
Tel: 0131 527 6932

Introduction

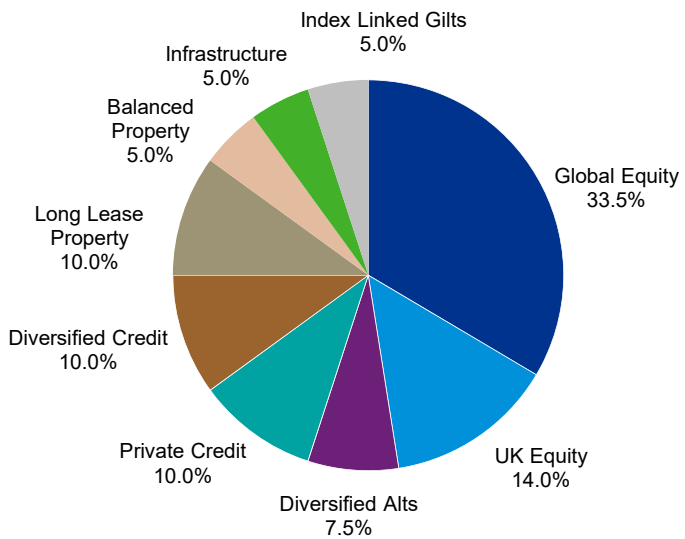
Addressee

- This report is addressed to Scottish Borders Council ("the Council") as administering authority of the Scottish Borders Council Pension Fund ("the Fund").
- The focus of the report is to review the Fund's existing investment arrangements and consider whether the strategy remains aligned with the Council's long term objectives for the Fund.

Background

- The Fund's investment strategy has delivered strong asset returns in recent years during a period in which most growth asset markets have trended upwards.
- Throughout this period the Committee has successfully evolved the investment strategy in order to exploit attractive market opportunities, whilst reducing risk.
- We have been engaged by the Council to undertake a review of the strategy to quantify the inherent risks and consider options for evolving the Fund's investment strategy. The strong investment growth over recent years has delivered a strong funding position.
- This paper provides an overview of:
  - The key objectives for the Fund;
  - The current investment strategy, including examining the expected funding trajectory and the inherent risks;
  - The key drivers of risk within the current strategy and how these can be managed in the current environment; and
  - Analysis of the current and alternative investment strategies for the Council to consider.
- The aim of this review is to consider the suitability of the current strategy, and focus on the longer-term direction of travel.

Target Strategic Benchmark



- As part of the Investment strategy review conducted in 2016, the Council agreed to reduce the Fund's strategic allocation to equities, in favour of assets that provide contractual returns and inflation protection in order to increase the certainty of the return profile and achieve a reduction in funding level volatility.
- This was achieved primarily via through the introduction of allocations to Private Credit, Long Lease Property and Infrastructure.
- The transition to move to the agreed strategy remains in progress as capital is drawn into private credit and infrastructure.
- Today, the Fund retains exposure to a blend of active and passive investment managers, across both public and private markets.

Objectives

Objectives

- We understand the Council's funding objectives are:
  - Set levels of employer contribution that will build up a fund of assets that will be sufficient to meet all future benefit payments from the Fund; and
  - Build up the required assets in such a way that produces levels of employer contribution that are as stable as possible through: ensuring effective and efficient management of employer's liabilities; and allowing the return from investments to be maximised within reasonable risk parameters.
- Thus the objective is to deliver a return that delivers full funding with as little volatility as possible (to maintain stable contributions). The assumptions underlying the Actuary's funding basis is an important factor in determining the return requirement.

Evolution

- The Fund remains open to new members and future accrual. It is therefore growing due to new liability accrual and also due to interest accruing on past service liabilities. The liabilities are also maturing (the proportion of pensions is growing) and this will change the cash flow profile of the Fund (making income and volatility key considerations going forward).
  - The Council, with KPMG, continues to consider the Fund's cashflow requirements, and how these are due to evolve both in the short and medium-term.
- The Fund is expected to grow at a rate above that of the growth in the Council budgets. This means that (all else being equal), absolute risk is growing over time. Maintaining 'stability' would require a gradual reduction in risk over time.

Key considerations

- The Council has developed a clear plan for managing the Fund's investment strategy to achieve the long term objectives for the Fund.

1. SPONSOR COVENANT
STRONG COUNCIL COVENANT BUT BUDGETS UNDER PRESSURE

2. FUNDING
ACTUARIES BASIS SETS REQUIRED RETURN

3. LIABILITIES
MATURING GRADUALLY AND GROWING VERSUS SPONSOR BUDGET

4. ASSET STRATEGY
DESIRE FOR RISKS TO BE MANAGED

- The Council has already taken steps to reduce the Fund's volatility by reducing the Fund's concentration in equities in favour of assets which provide more contractual income and, increasing the assets exposure to inflation to better match the Fund's inflation linked liabilities.
- We examine the current strategy and funding basis before looking at potential alternative strategies.

What return is required?

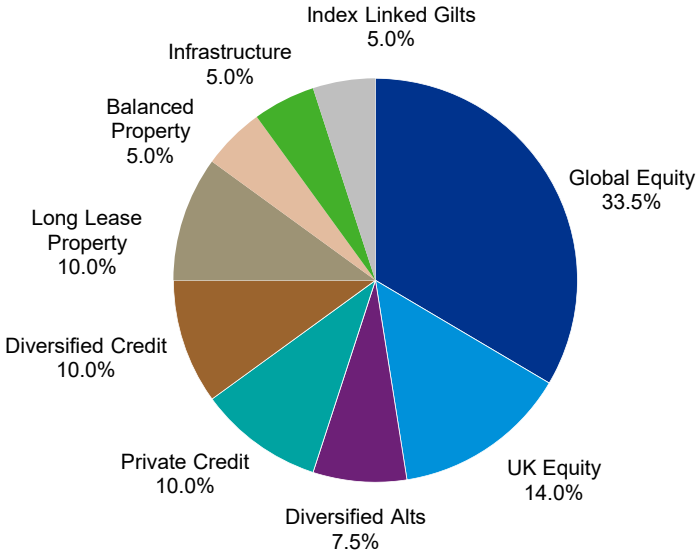
Overview

- The discount rate used to value the liabilities at the last actuarial valuation was 5.0%.
  - The discount rate can be interpreted as the Actuary's prudent assessment of the return the assets are expected to deliver over the long term.
  - The Actuary therefore requires the assets to deliver at least 5.0% p.a. to achieve full funding based on the agreed contributions (all else being equal).
- Whilst the valuation basis has no explicit link to Gilt markets, we would expect that there is an implicit connection – in the belief that the prospective future returns from all markets are inherently linked. Low prospective returns from gilt markets would imply lower future returns from other markets (assuming investors are rational).
- As at 31 March 2017, the date of the most recent Actuarial Valuation, the required return of 5.0% translated to a return of Gilts +3.1% p.a. (relative to a 20 year gilt yield). Whilst markets have been volatile in the interim period, gilt yields remain in a similar position as at 31 March 2018.
- We estimate the expected long term return for the current strategy is around Gilts + 4.6% p.a. The difference between the Gilts +4.6% p.a. best estimate and Gilts +3.1% p.a. basis in 2017 reflects an element of prudence.
- Given the strong funding position, we believe that the Committee's focus should continue to be on risk reduction in the investment strategy whilst maintaining a broadly similar target return to current.
- The Council should consult the Actuary on any proposed changes to the Fund's investment strategy, to understand the impact, if any, to the underlying funding basis.

1. Current Strategy

Overview

Current Strategic Benchmark



Estimated Funding Position (31 March 2018)	
Assets	£677.6m
Estimated Liabilities (TP basis)	£579.7m
Estimated Funding Surplus	£97.9m

Current Strategy (as at 31 March 2018)	
Expected Return (p.a.)	Gilts + 4.6%
Return requirement (p.a.)	Gilts + 3.1%

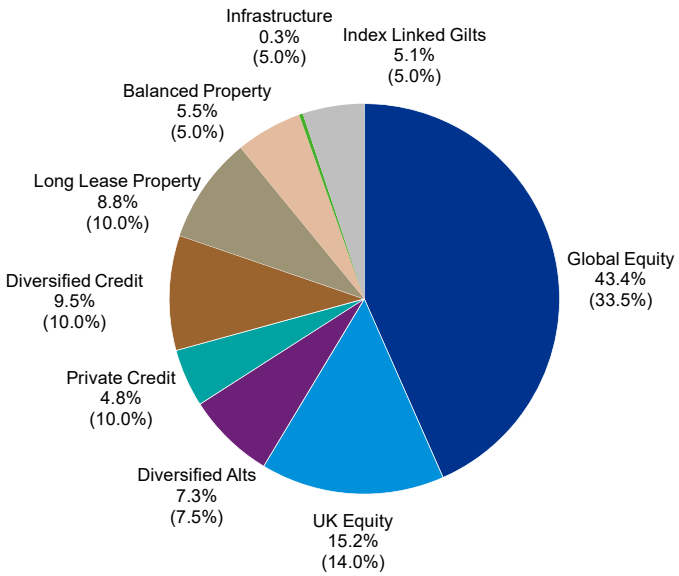
Observations

- The Fund's funding position has significantly improved over the past 3 years, with the surplus increasing from £2.9m to £80.6m primarily due to the strong investment performance.
- The Fund's investment strategy is well diversified across a range of both public and private markets.
- The Fund retains a material allocation to Equities to drive growth. Equities have performed strongly over recent years.
- The strong funding position provides an opportunity to further reduce risk.

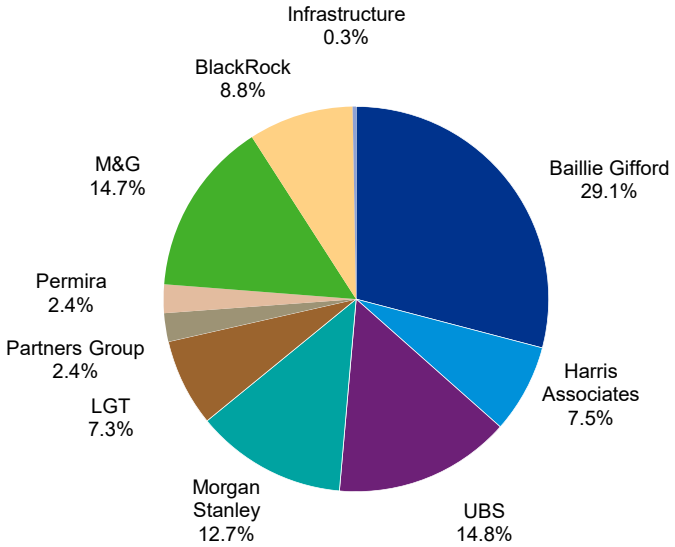
Source: Investment managers and KPMG based on Actuarial information provided by Barnett Wadingham

Strategy and structure

Actual Asset Allocation (vs Target)



Current Manager Allocation



Observations

- As at March 2018 the Fund's investment strategy comprised of 9 individual asset classes and 10 individual managers (excluding infrastructure) with exposures a blend of active and passive mandates across both public and private markets.
- The Private Credit and Infrastructure mandates draw capital as and when opportunities arise, as such these mandates are underweight relative to the strategic benchmark. Whilst this process is being carried out capital is being held within the Global Equity mandates on an interim basis (c. 10.0% overweight).
- The Fund's Infrastructure mandate is implemented in conjunction with the Lothian Pension Fund. The allocation is c.4.7% underweight vs a target of 5.0%.
- The Fund's private credit allocation is c.5.2% underweight vs a target of 10.0%. The Fund has agreed to commit a further 2.5% to Partners Group's 2018 Direct Lending (Private Credit) Fund. This should call down the committed capital over the next 12 months.

Notes: Totals may not sum due to rounding. Asset and manager allocation excludes cash allocation of 0.2%. Data as at 31 March 2018.Source KPMG, based on manage data.

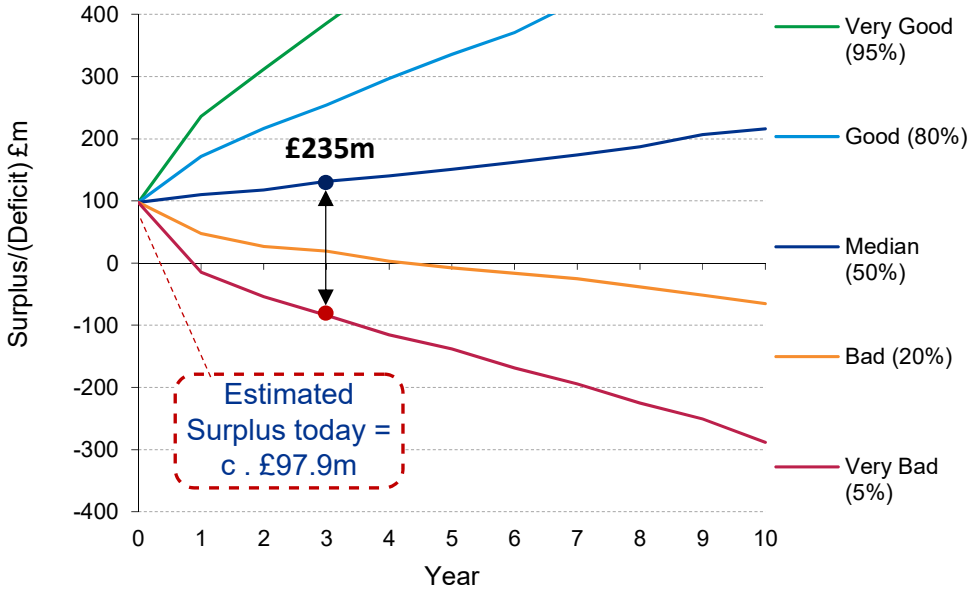
Strategy progress since 2016

Decision taken at 2016 Review	Summary and Rationale	Progress to date
1. Reduce reliance on equities	▪ The Council opted to reduce the Fund's strategic allocation to equities from 65% in favour of opportunities that target a similar level of return with a less volatile return profile and increased diversification benefits. ▪ As the sizeable equity allocation was the dominant driver of investment returns, reducing reliance on the asset class broadened the underlying return drivers for the Fund.	▪ Since 2016, the Fund has gradually reduced equity exposure up to 2018, but remains overweight relative to the strategic benchmark. ▪ The capital earmarked for the remaining drawdowns for the private market mandates is currently being held in equity, this position is expected to reduce as the capital committed to the private mandates is drawn.
2. Increase exposure to sources of inflation	▪ The Council agreed to increase the Fund's exposure to inflation-linked assets. ▪ The majority of the pension benefits in the Fund are linked to inflation. A higher allocation to inflation-linked assets provides a better match for pension payments linked to inflation and decreases the risk position of the Fund.	▪ The Council restructured the Fund's bond portfolio in August 2017 to focus on Index-linked Gilts, which provide direct inflation exposure. ▪ Additional direct inflation exposure is provided via the Long Lease Property mandate (invested during the course of 2017), and the infrastructure allocation which is in the process of being implemented in conjunction with the Lothian Fund.
3. Exploit long term investment horizon	▪ The Council agreed to increase exposure to illiquid assets to exploit it's ability to invest for the long term and earn an attractive illiquidity premium. ▪ Pension funds are one of the few investors able to exploit a return premium available to those who can tie up capital in long term opportunities.	▪ The Fund invested in two private credit mandates, managed by Partners Group and Permira, and a Long Lease Property mandate with BlackRock. ▪ The Long Lease Property mandate and private credit mandate with Permira mandate are now fully drawn. The initial commitment to Partners Group has been drawn, with the agreed commitment to their 2018 fund due to begin drawing capital later this year.

Looking forward - Current funding basis

Potential funding progression

(Current Strategic Benchmark)



Source: Investment managers and KPMG based on Actuarial information provided by Barnett Wadingham

Funding analysis over 3 years	
Expected Surplus	**+£133m**
1 in 5 chance (20%)	£11m
1 in 20 chance (5%)	(£103m)

- The central expectation is for the funding positon to continue to improve and increase over time (note, we have factored in the contribution rates agreed in the 2017 Actuarial Valuation).
- Although progress has been made since the 2016 strategy review, the analysis above highlights the degree of variation (both upside and downside) that the Fund's funding position remains exposed to under the current strategy – this could have a material impact on the funding strategy if the downside "bad experience" plays out.
- Given the strong funding position, there is scope to remove further risk and reduce the impact of any potential downside scenarios from the strategy.

Funding basis sensitivity

Sensitivity of funding position (31 March 2018)

	Current funding basis	Typical LGPS funding basis
Discount rate (Gilts plus % p.a.)	3.1%	1.8%
Current surplus / (deficit)	£98m	(£21m)
Current funding level	117%	97%
Expected surplus / (Deficit) in 3 years time	£133m	£29m
Expected surplus / (Deficit) in 10 years time	£219m	£152m

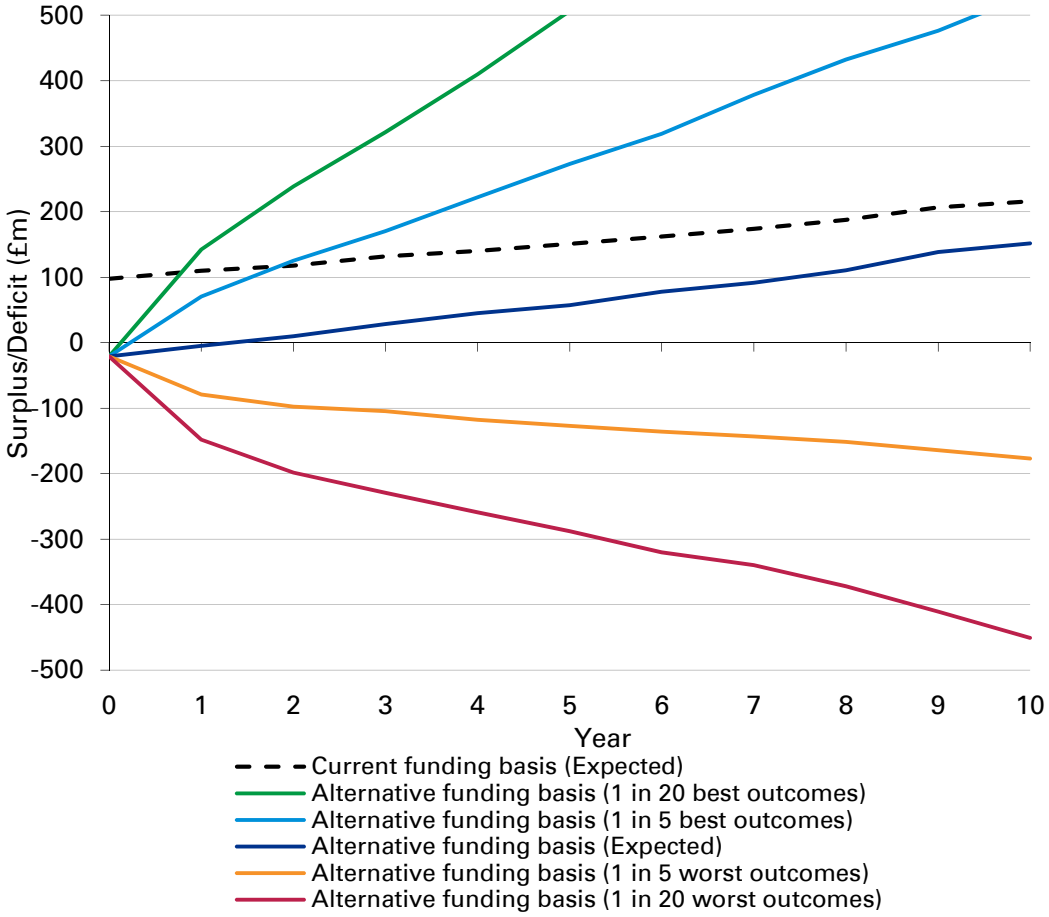
Source: KPMG calculations as at 31 March 2018, based on Actuarial information provided by Barnett Wadingham.

Observations

- In order to help the Committee assess the robustness of the current funding position and strategy, we have undertaken additional analysis using a revised funding basis measure. This basis is more closely aligned to some other Scottish LGPS Funds and uses a more conservative measure of the funding position.
- Based on the Fund's current discount rate assumption, the Fund has a funding level of c. 117%.
- When compared to the measurement of some other Scottish LGPS, the Fund's discount rate assumption is relatively high.
- Using a discount rate of Gilts + 1.8% p.a. (which is more consistent with some other LGPS), the Fund's funding level would drop to c. 97% and would have a deficit of c. £21m.

Looking forward - Alternative funding basis

Estimated funding progression - Expected progression on alternative funding basis



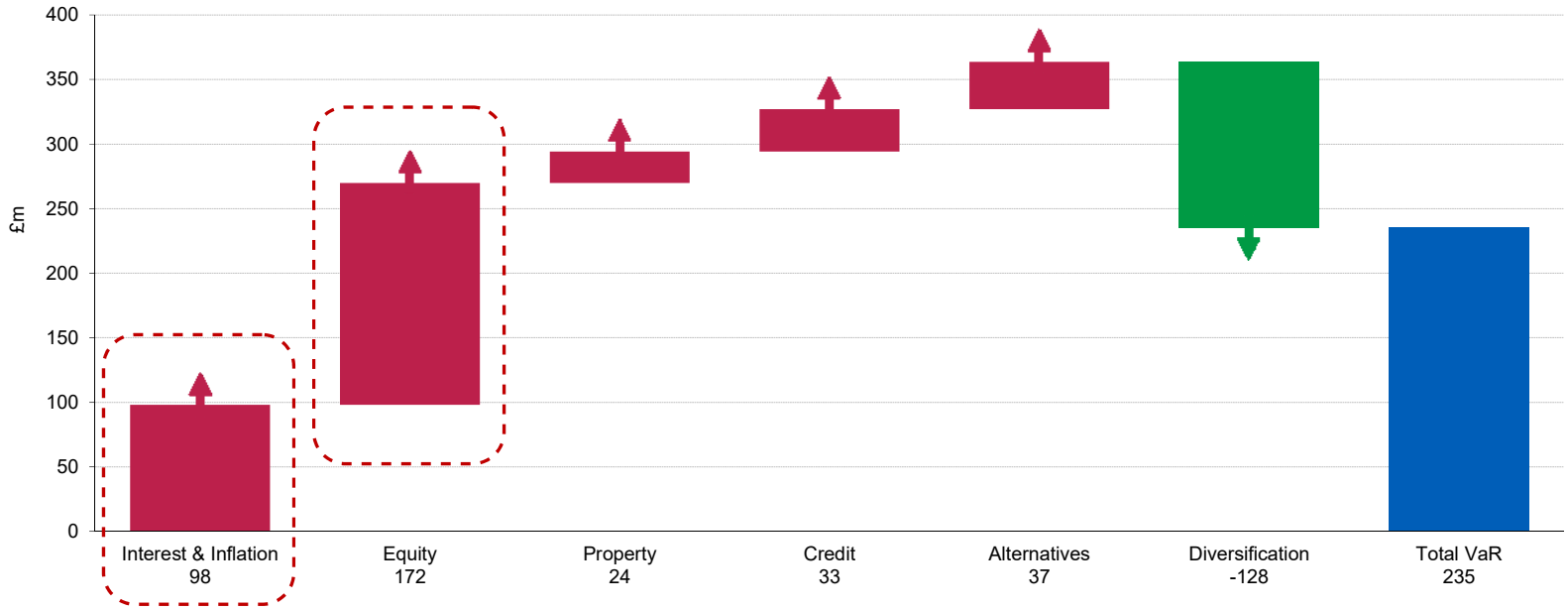
Funding analysis over 3 years	
Expected Surplus	**+£29m**
1 in 5 chance (20%)	(£104m)
1 in 20 chance (5%)	(£229m)

Notes: Estimated funding progression based on KPMG calculations using Actuarial data provided by Barnett Waddingham. Future service rates assumed unchanged from current funding basis.

Concentration of risk

Breakdown of risk

1 in 20 downside risk over 3 years



- The Fund's largest risk is equity risk, stemming from the 47.5% strategic allocation to Global and UK equities
  - Reducing this allocation will substantially reduce funding risk but will also have an impact on impact expected returns.
  - The analysis above is based on broad equity market exposure – the risk is mitigated at the margins by the Fund's active managers.
- Interest rate and inflation risk represents the second largest risk exposure
  - Action has been taken to address this via the introduction of Index-linked Gilt mandate and Long Lease Property mandate which both offer direct inflation protection. However, there is scope for this risk to be addressed further if desired.

Equity portfolio structure

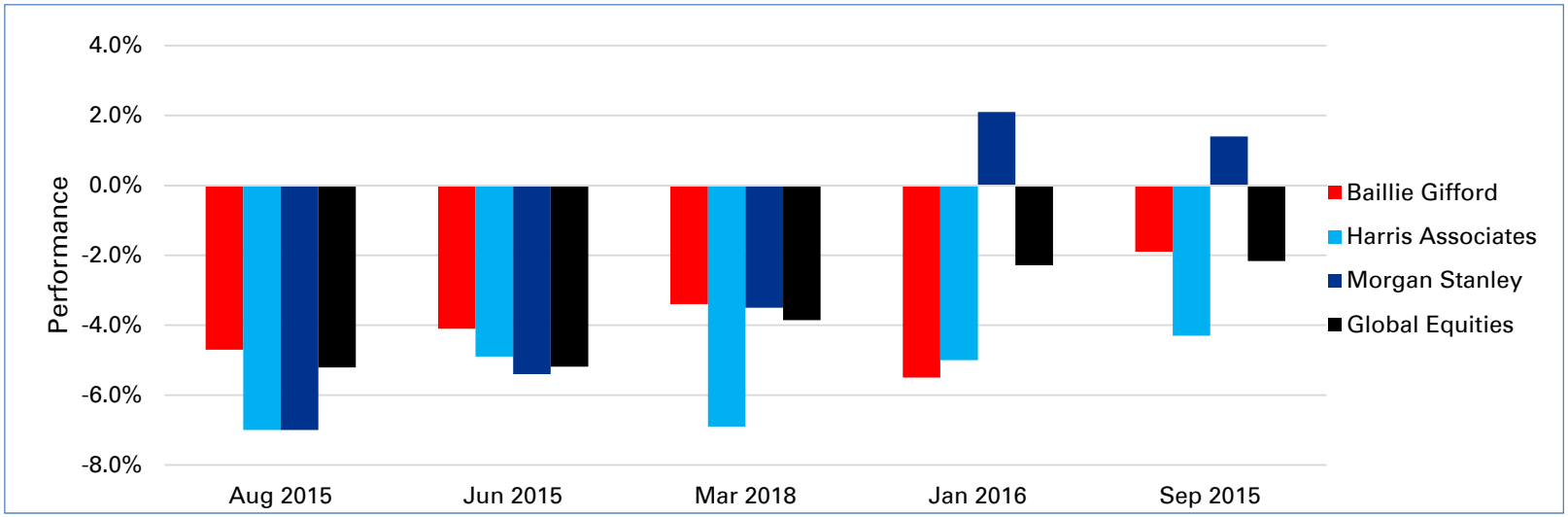
Structure of the Fund's equity portfolio

Manager	Geography	Style	Description
Baillie Gifford	UK	Active	Takes offsetting positions relative to a UK equity benchmark to hold stocks which will outperform.
UBS		Passive	Tracks a UK equity benchmark for broad market exposure.
Baillie Gifford	Global	Active – Growth	Focussed on **Growth stocks** (i.e. stocks which are expected to experience significant growth).
Harris Associates		Active – Value	Focussed on **Value stocks** (i.e. stocks which appear under- or over-valued), to benefit from pricing anomalies.
Morgan Stanley		Active – Large Brands	Focussed on **large cap, brand name stocks** which produce attractive dividend growth and modest capital growth.

- The equity portfolio is well diversified by region, manager style, and across active manager risk.
- We would expect that the active equity allocation to Morgan Stanley offers some defensive characteristics.
- We believe there may be value in analysing the historical performance of the mandates to determine how the overall mix behaves in a market downturn and where consideration should be given to changing this.

Performance in falling equity markets

Performance in worst 5 equity months over past 5 years

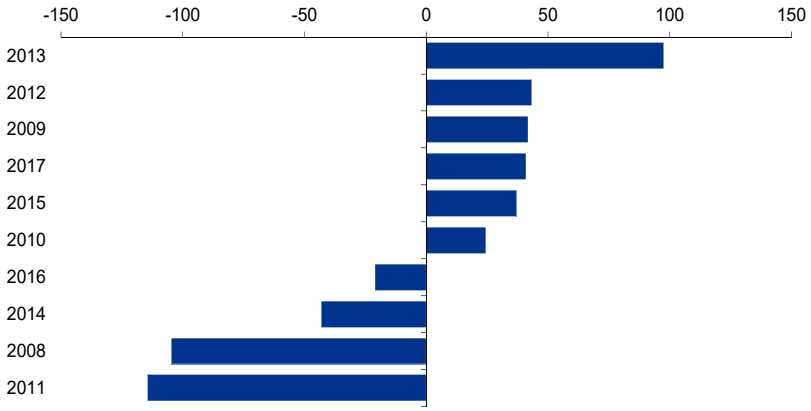


Performance in worst 5 equity months over past 5 years					
Month	**August 2015**	**June 2015**	**March 2018**	**January 2016**	**September 2016**
Baillie Gifford	-4.7%	-4.1%	-3.4%	-5.5%	-1.9%
Harris Associates	-7.0%	-4.9%	-6.9%	-5.0%	-4.3%
Morgan Stanley	-7.0%	-5.4%	-3.5%	2.1%	1.4%
MSCI World	-5.2%	-5.2%	-3.9%	-2.3%	-2.2%

Notes: Analysis is high level and for illustrative purposes only (due to short time period and limited performance data). More detailed analysis should be carried out if further consideration on the structure of the Fund's equity portfolio is to be carried out.

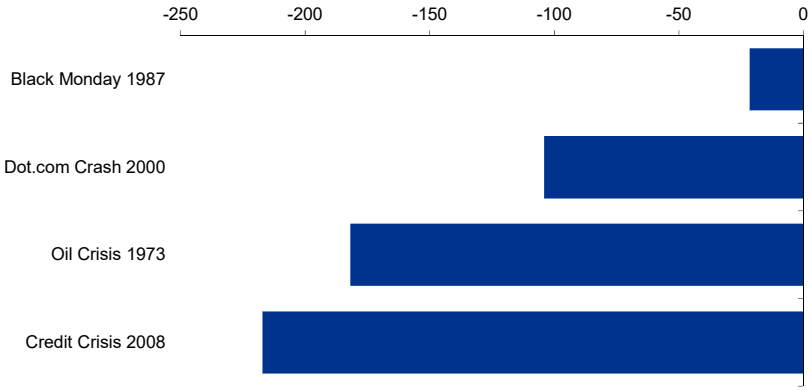
Historic scenario testing

Historic Scenario Analysis – impact (past 10 years)



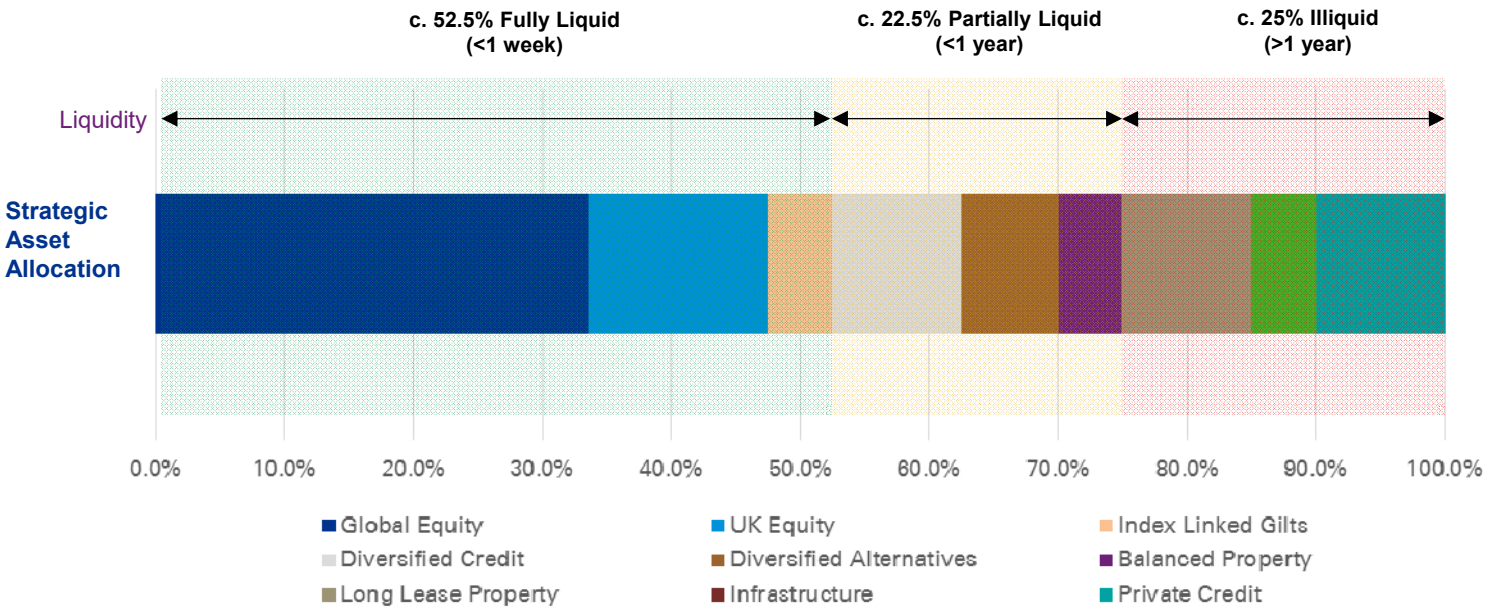
- The chart opposite shows the impact on the funding position if we were to re-run each of the past 10 calendar years from today. This is based on the agreed strategic allocation (we note that this actual allocation is not yet aligned with target).
- The target Strategic allocation of the Fund is generally well positioned to withstand a wide range of economic scenarios.

Past Crises Scenario Analysis – Impact



- The chart opposite shows the illustrative impact on the funding position should past crises play out again in today's market conditions.
- Though we note that these past crises events were extreme in nature and as a result of specific shocks to investment markets, they do show the Fund's sensitivity to significant market events, should anything similar occur in the future.

Liquidity profile



Observations

- We estimate most of the asset liquidity lies within 1 month, with c. 70% of assets able to liquidated over this period.
- Following the previous Investment strategy review, the Council opted to invest in a range of less liquid assets (Infrastructure, Private Credit and Long Lease Property) in order to try and exploit the illiquidity premium available on these investments.
- Given the liability profile of the Fund, we believe, there remains scope to increase the Fund's allocation to less liquid assets, above current cash flow requirements, in order to further increase the Fund's illiquidity premium and exploit your key advantage as a long-investor.
  - Currently, the Fund is paying out c.£19m p.a.in liability payments. This will increase as the Fund matures but there remains significant headroom. This does not account for any transfer value payments, these are variable and uncertain and would be in addition to the liability payments.

2. Alternative Strategies

Potential direction of travel

Further reduce reliance on equities	▪ The Council has made good progress in diversifying return drivers to reduce the reliance on equities to generate return. ▪ Reducing equities further would impact expected returns but would add further diversification and remove a material level of risk.
Continue to allocate to illiquid assets	▪ To date, the Council has implemented a Long Lease Property mandate, and is in the process of implementing private credit and infrastructure mandates. ▪ A number of these allocations with continue to wind down, so continuing to allocate capital is important. We are continuing to identify good opportunities.
Add to inflation exposure	▪ The Council has increased the Fund's direct inflation exposure via the Long Lease Property mandate and the restructure of the bond portfolio to include Index-linked Gilts. Consideration could also be given to senior infrastructure debt, though we note that the additional premium needs to be balanced against the very significant illiquidity. ▪ Increasing inflation protection further will be helpful to manage risk.
Consider infrastructure mandate implementation	▪ The Council is in the process of implementing the agreed Infrastructure allocation in conjunction with Lothian. ▪ We understand that there is a desire to increase the allocation towards target more quickly. There are a range of equity and debt funds that could be considered in order to achieve this whilst complimenting the existing approach.
Management fees	▪ The Council should continue to identify ways to reduce fees and could streamline management arrangements.

Alternative strategies

Asset Classes	1. Current Strategic Benchmark	2. Introduce Junior Infrastructure Debt	3. Introduce Junior Infrastructure Debt and JCRED	4. Inflation and infrastructure focus	5. Infrastructure focus
Global Equity	33.5%	↓ 33.0%	↓ 31.5%	↓ 30.0%	↓ 30.0%
UK Equity	14.0%	↓ 12.0%	↓ 11.0%	↓ 10.0%	↓ 10.0%
Long Lease Property	10.0%	10.0%	10.0%	↑ 12.5%	10.0%
Balanced Property	5.0%	5.0%	↓ 2.5%	↓ 2.5%	5.0%
Diversified Alternatives	7.5%	↓ 5.0%	↓ 5.0%	↓ 0.0%	7.5%
Diversified Credit	10.0%	10.0%	10.0%	10.0%	10.0%
Direct Lending	10.0%	10.0%	10.0%	10.0%	10.0%
Index-linked Gilts	5.0%	5.0%	5.0%	↑ 10.0%	5.0%
Infrastructure Debt (Senior)	-	-	-	-	↑ 5.0%
Infrastructure Equity	5.0%	↑ 10.0%	↑ 10.0%	↑ 10.0%	↑ 7.5%
Infrastructure Debt (Junior)	-				
Commercial Real Estate Debt (Junior)	-	-	↑ 5.0%	↑ 5.0%	-
Exp. Return (Gils + p.a.)	4.6%	4.6%	4.7%	4.3%	4.5%
Expected funding Surplus (3 years)	£133m	£132m	£134m	£124m	£131m
1 in 20 Upside Position	£409m	£397m	£388m	£347m	£373m
1 in 20 Downside Position	(£100m)	(£92m)	(£84m)	(£72m)	(£87m)
Value at Risk (1 in 20 chance)	£235m	£225m	£218m	£196m	£218m

Notes: Value at Risk ("VaR") measure represents the increase in expected deficit in 3 years time under the 1 in 20 (5%) worst investment outcome.

Alternative strategy considerations

Consideration	Description	Comments
1. Infrastructure implementation	▪ Given the nature of infrastructure projects, the implementation period can lengthy and the diversification achieved through investing in projects directly can be limited.	▪ The Council could diversify and increase the speed of implementation of the infrastructure mandate by considering alternate implementation routes for equity and the introduction of debt.
2. Topping up the illiquid mandates to the strategic benchmark	▪ The Fund's allocation to the BlackRock Long Lease Property fund and illiquid credit mandate are strategically underweight.	▪ Consideration should be given if these should be topped up to the agreed benchmark weight as part of any strategy change.
3. Capital held in respect of private credit and infrastructure mandates	▪ Given the private credit and infrastructure mandates will draw down capital as and when opportunities arise, the Fund must hold the committed capital prior to this being called. ▪ Currently the capital is held in equities until drawn.	▪ Given the direction of travel is to reduce the equity allocation, we propose that this capital earmarked for infrastructure equity is held in equities and capital earmarked for direct lending is instead held in Diversified Credit until drawn. ▪ The diversified credit mandate is less volatile than equities and represents a better proxy than equity for the destination asset classes, ▪ This will still leave the option to draw the capital down as and when required, however, consideration needs to be given to the liquidity terms on offer.
4. Mandates to draw down as part of the reduction in equities	▪ Given the Fund has exposure to 5 equity funds via 4 different managers, there are several mandates which the Fund could draw upon to reduce the allocation. ▪ Consideration should be given to streamlining the active equity managers.	▪ Given the strong performance of the Baillie Gifford mandates, these mandates are overweight relative to their strategic benchmark. ▪ We propose the Fund looks to crystallise these recent gains, opting to reduce the Global Equity and/or UK Equity exposure the Fund has with Baillie Gifford to fund any strategy changes.

Alternative strategy considerations (cont.)

Consideration	Description	Proposal
5. Reducing the Diversified Alternatives mandate	▪ The Fund currently has a segregated diversified alternatives mandate with LGT. ▪ LGT have confirmed the minimum amount they would hold in respect of a segregated allocation is c.£35m or 5% of total assets.	▪ The strategies proposed have taken due consideration of the minimum threshold for LGT to maintain a segregated portfolio, and have ensured this is not breached. ▪ If this allocation is to be reduced, we propose to engage the manager to assess the most pragmatic reduction of the mandate. ▪ Consideration should be given to the relatively high fees in respect of the fund (c. 1.5% p.a.) and whether the Council believe this is appropriate given both the nature and past performance of this mandate. If the mandate is to be retained, we believe the Council should consider negotiating a lower fee scale with the manager.
6. Potential allocation to Diversified Growth Fund	▪ The Council had expressed an interest in investing in a diversified growth fund.	▪ Given the Fund size, we believe the Fund already has access to a diverse range of asset classes directly, with greater efficiency and control and more cost effectively.
7. Transaction costs	▪ There is explicit transition costs associated with the movement of any assets.	▪ The estimated round trip transaction costs in normal market conditions for the asset classes considered (as a % of assets moved) are : ▪ Equity: up to c. 0.3% ▪ Property: up to c. 7.0%* ▪ Diversified Alternatives: c. 0.5% ▪ Diversified Credit: c. 0.5% ▪ Infrastructure Equity (Pooled): Up to c. 1.0% ▪ Junior CRED: None expected ▪ Infrastructure Debt: c. 0.5%

* Many property funds can currently be exited at a premium to reported value on the secondary market.

3. Summary and Next Steps

Summary and next steps

Summary

- The Fund has delivered strong investment returns in recent years during a period in which most asset markets have trended upwards.
- Throughout this period the Committee has successfully evolved the investment strategy in order to exploit attractive market opportunities and reduce risk. This has come with some increased governance for the investment management arrangements as the manager roster has grown.
- The implementation of the current strategy is not yet complete. The Council should consider whether:
  - Any action to top up the LLP and Direct Lending allocations is desired
  - Any action to accelerate the allocation into infrastructure is desired.
- The Fund has achieved a strong funding level (c.114% according to the most recent Actuarial valuation as at 31 March 2017). So whilst the current investment strategy is robust, it is delivering more returns and more risk that is strictly required.
- It is possible for the Council to continue to take advantage of current market conditions and reduce risk further while looking to broadly maintain the current level of returns.
- We have analysed several alternative strategies and new asset classes for consideration, to illustrate how the risk/return profile of the current strategy can continue towards.
- We are conscious that the Council should consider both the number of managers and potential costs in making any further changes.

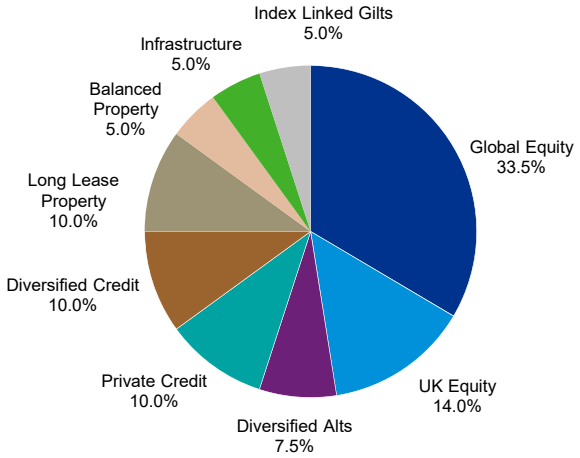
Next steps

- The Council should consider:
  - The implementation of the existing strategy and whether a top up to the allocations to LLP and Direct Lending is desired.
  - Its view on the proposed investment strategy and whether there is an appetite to exploit further any of the alternatives proposed.
- Whilst secondary to the decision on the strategic asset allocation, the Council will also have to consider the Fund's investment manager line-up and whether any streamlining of this might be desired. In particular, the Council should consider the equity allocation and whether a more streamlined/defensive structure is desired.
- We look forward to discussing this report with the Council.

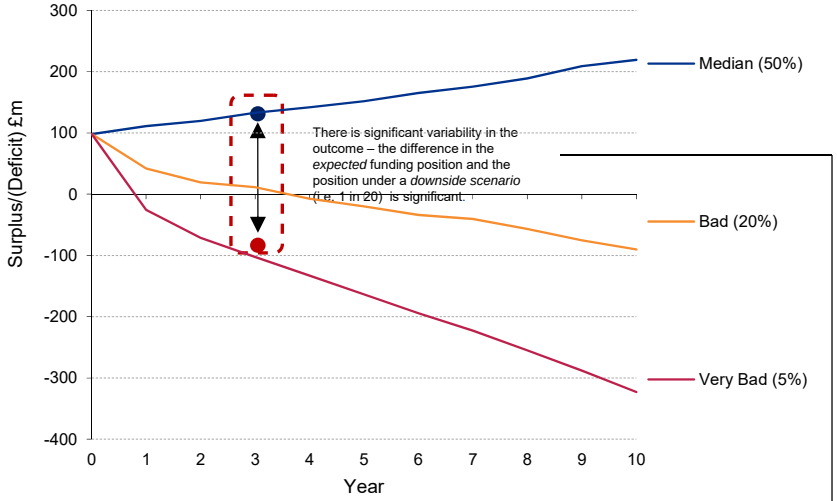
Appendices

A1. Current strategy - Summary

Current Asset Allocation
(Strategic Benchmark Weights)



Expected Funding Level Progression
(Funding Basis)



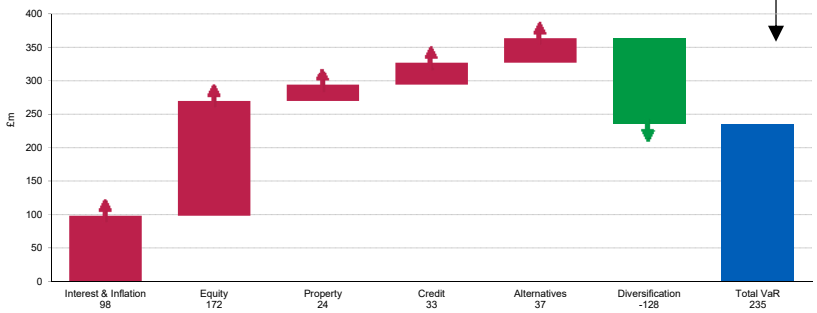
Summary

Key Characteristics	Funding Basis
Expected return (gilts plus)	4.6%
3 year 95% VAR	£235m
Deficit level in 3 years (95% worst outcome)	(£103m)

Notes: Calculations based on the 31 March 2017 actuarial valuation, rolled forward to 31 March 2018, asset valuations as at 31 March 2018 and KPMG's long term modelling assumptions.

VaR: 3 year 95% Value at Risk represents the increase in expected deficit in 3 years time under the 1in 20 worst investment outcome.

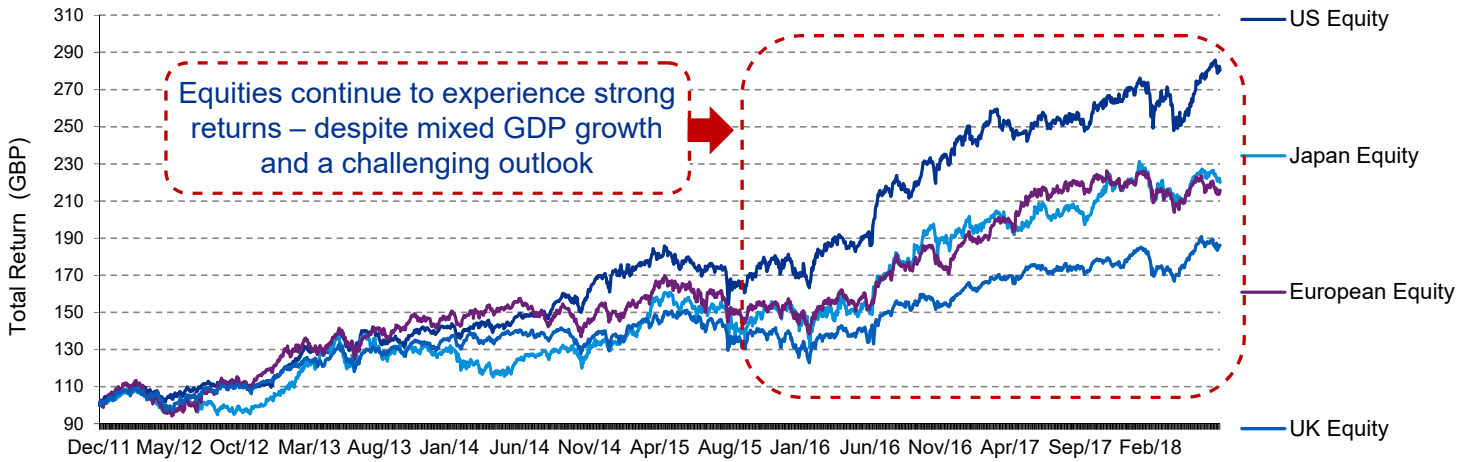
3 year 95% Value at Risk (VaR) decomposition
(Funding Basis)



A2. Key risk exposures - Equity risk

Equity risk

- The Council retains a significant allocation to UK and global equities (c. 47.5% of Fund assets) as a driver of long term returns.
- Given the requirement to generate high returns, we believe equities will remain at the heart of the long term growth focussed investment strategy for the Fund given its long term investment horizon and ability to tolerate some short term volatility.
- To date, this equity risk has paid off for the Fund with equity markets marching higher supported by global quantitative easing and central government stimulus despite a challenging economic backdrop. It is inherently difficult to time entry and exit from equity markets and tactical calls on markets are extremely difficult for even the most well resourced and highly regarded asset managers.
  - Equity markets have performed extremely well since 2009 and many developed market indices have hit new or multi decade highs.
  - A number of market valuations now look relatively stretched (the US in particular) on a number of measures (i.e. cyclically-adjusted price earnings, price/ earnings, price to book).
  - In the current environment, we believe there is a reasonable rationale to reduce equity risk to exploit a wider range of high returning investment opportunities that should prove more robust if the economic environment deteriorates.

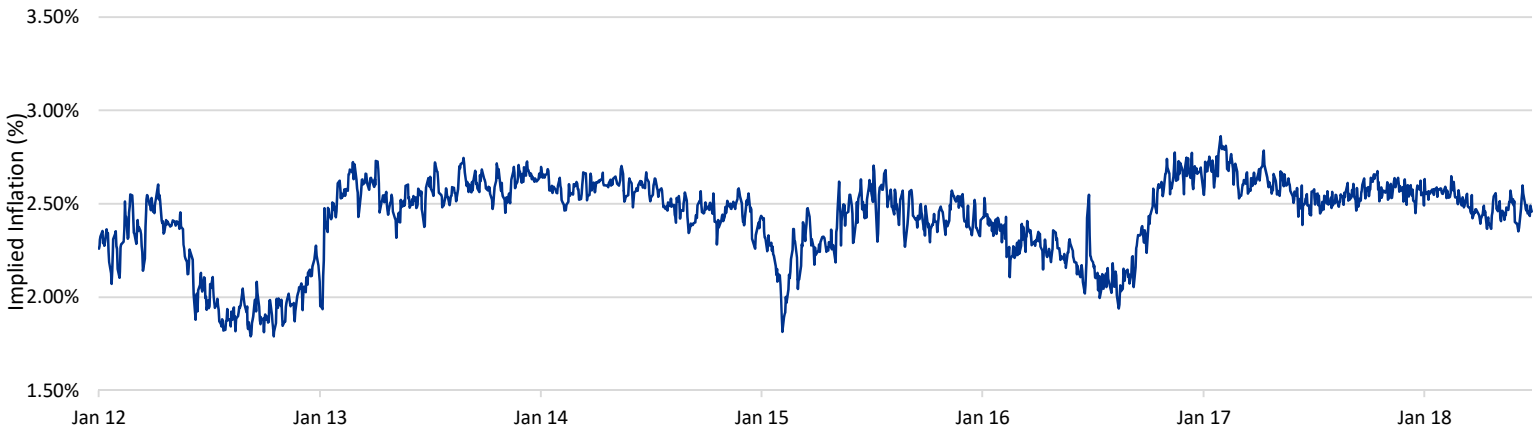


A2. Key risk exposures - Inflation risk

Inflation risk

- Despite a benign inflation environment over the past few years, recent market events and easing monetary policy have increased upward inflation pressures (both UK and global) and inflation is expected to increase over the next few years. As the assets do not currently have a significant link to inflation, any rapid increase in inflation would be detrimental.
- The Fund could consider increasing the allocation to assets directly linked to inflation.

20 Year Implied Inflation (CPI)



A3. Asset class assumptions

Introduction to the assumptions

- These are our "best estimate" asset class return, volatility and correlation assumptions. We believe there is a 50:50 chance that the actual outcome will be above/below our assumptions.
- The assumptions are long-term, for a 10-year period.
- Return assumptions are:
  - Annualised (i.e. geometric averages), net of management fees.
  - Expressed relative to the yield on fixed interest gilts (the annual yield at the 10-year tenor on the Bank of England spot curve). This yield was 1.3% at 31 March 2018.
  - Before tax. UK pension schemes are exempt from tax on investments. The impact of taxation may reduce returns for other investors.
- Volatility assumptions are based on the standard deviation of annual returns over a 10-year period.
- Bond volatilities are sensitive to the duration of the index. Our Fixed Interest Gilts (FIG) and Index-Linked Gilts (ILG) assumptions both relate to Over 15 Year indices, but the cashflow profile of the ILG index is considerably longer than the FIG index. Hence the difference in volatilities does not necessarily mean that real yields are assumed to be more volatile than fixed yields.
- Please note that the assumptions have a subjective element, particularly for asset classes with less history and greater reliance on active management.

Asset Class	Sector [1]	Return [2]	Volatility [3]
Global Equity	Developed (passive)	4.0%	20.0%
	Developed (core active)	4.5%	20.5%
	Developed (unconstrained)	5.0%	21.0%
	Emerging (passive)	5.0%	30.0%
Alternatives	Hedge Funds: Multi-Strat FoF	2.5%	10.0%
	Private Equity	7.0%	30.0%
	Diversified Alternatives	6.0%	22.0%
Property	UK Balanced	1.5%	13.0%
	Long Lease	1.0%	8.0%
DGF	Diversified Growth Funds	3.5%	12.0%
Gilts	Fixed Interest Gilts (passive) 4	0.0%	6.5%
	Index-Linked Gilts (passive) 4	0.0%	11.0%
Credit	Investment Grade (passive) 4,5	1.3%	6.5%
	Diversified Credit 5	2.1%	10.0%
	Distressed Debt	6.0%	26.0%

Notes: 1 Includes active management except where specified as passive
2 Expected return per annum, net of fees, relative to the yield on fixed-interest gilts
3 Expected standard deviation of absolute annual returns
4 Long-dated bonds (>15yr index); note durations for FIG and ILG differ considerably
5 Includes an allowance for downgrades and defaults (0.2% for Investment Grade)

Source: KPMG

A4. Modelling methodology

Modelling Principles

- SOFIA is a stochastic model that simulates a large number of possible future economic outcomes, in which financial conditions develop in a number of different ways, defined by assumptions for average outcomes and the range of variability. The results of the projections are shown by ranking the calculated outcomes from best to worst and presenting the following scenarios:
  - Median: this is the middle outcome and can be thought of as the "expected result". Half of the modelled outcomes are better than this and half are worse.
  - Bad: this splits the results so that there is a one in five (20%) chance of having a worse outcome. This is a measure of risk.
  - Very Bad: this splits the results at a one in twenty (5%) chance of having a worse result. This is a more extreme measure of downside risk.
  - Good and Very Good (where shown): these illustrate possible positive outcomes.
- The "Value at Risk", where shown, is defined as the difference between the Median scenario and the Bad or Very Bad scenario, i.e. it represents the variability of funding outcomes and shows the magnitude of the possible downside from the expected result. Please note that this is not the same as the possible downside loss from the starting position.

Investment Strategy

- Different investment strategies are modelled in order to illustrate the effects of different risk/return trade-offs. For each portfolio, the model assumes that the chosen strategy remains fixed over the full projection period. Assets are annually rebalanced back to the original allocations.

Investment Strategy

- Where the model illustrates a scheme-specific funding basis, the funding basis is calculated in the same way across all the investment portfolios modelled. We therefore focus on the effect of investment strategies on asset values and hence surplus/deficits, without the distorting effect of differing liability methodologies. However, in cases where the discount rate allows for a risk premium, the magnitude of the risk premium may depend on the proportion of return-generating assets in the portfolio, and therefore in practice the funding basis may be different under different investment strategies.

A4. Modelling methodology (cont.)

Modelling Principles (cont.)

Contribution Basis

- The model's projections may be based on either fixed or variable contributions:
  - "Fixed contributions" means that the current schedule of deficit contributions is assumed to remain in place for the full projection period. The purpose of this is to illustrate pure investment risk, showing the effect of differing investment strategies without the distorting effect of different amounts of money being contributed. In practice, however, the long-term downside scenarios would be less likely to be reached, as poor intermediate outcomes would lead to a requirement for additional contributions after future valuations.
  - "Variable contributions" means that the model simulates future actuarial valuations every three years, and calculates the future deficit contributions that might be required under the particular situations being projected. This illustrates the range of possible future contribution requirements.
- In addition to the deficit contributions, the model also calculates contributions required to fund future service accrual, if there are active members accruing additional pension entitlements. In this case a small amount of variability arises from the range of possible future inflation projections. Therefore the "fixed contribution" projections may still show minor differences in contributions between, for example, Median and Bad scenarios.

A5. Disclaimers

- The information contained herein is provided for the Scottish Borders Council. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.
- The output from our modelling is based on a large number of underlying assumptions. Changes to these assumptions can have a material impact on the results of the modelling.
- The outcomes shown are not intended to be the best possible, or worst possible outcomes. The actual outcome could be better than the 5th percentile, or worse than the 95th percentile.
- The modelling analysis is based on portfolios containing a wide range of asset classes and different approaches to fund management. Clients should not make decisions to invest in these asset classes or approaches to fund management based solely on the modelling analysis.
- Cashflow profile and liability figures are based on data provided by Barnett Wadingham.
- The only risk factors we have considered in our modelling are those that affect the values of pension schemes' assets and the financial assumptions used to value schemes' liabilities. Some of the risks we have not considered include demographic risks such as the life expectancy of pension schemes' members and future changes to members' benefits.
- Past performance cannot be relied upon as a guide to the future.

The contacts at KPMG in connection with this report are:

David O'Hara
Partner
Investment Advisory
KPMG LLP (UK)
Tel: +44 (0)141 300 5533
david.ohara@kpmg.co.uk

Andrew Singh
Executive Consultant
Investment Advisory
KPMG LLP (UK)
Tel: +44 (0)131 451 7749
andrew.singh@kpmg.co.uk

Tony Hodgson
Consultant
Investment Advisory
KPMG LLP (UK)
Tel: +44 (0)131 527 6932
tony.hodgson@kpmg.co.uk

This page is intentionally left blank

INFORMATION UPDATE

Briefing Paper by Chief Financial Officer

PENSION FUND COMMITTEE & PENSION BOARD

13 September 2018

1 PURPOSE AND SUMMARY

1.1 **This briefing paper is to provide members of the Committee and the Board with an update on a number of areas which are being monitored and areas where work is progressing. Full reports on the individual areas will be tabled as decisions and actions are required.**

2 GMP RECONCILATON

2.1 Stage 2 of the GMP Reconciliation is progressing by ITM Limited on behalf of Scottish Borders Council. This stage of the project is the reconciliation of discrepancies between HMRC and Scottish Borders Council pension records for Active or Deferred members and Pensioners.

2.2 Scottish Borders Council received the latest report from ITM on 24 July 2018 and these are summarised below:-

	Representing No of Members	
35%	7,383	Percentage of fund members have been reconciled
44%	9,279	Percentage of fund members who are outwith the scope for reconciliation. Generally these are members who have no liability under the scheme having either pre 6 April 1978 service only or only post 5 April 206 service
21%	4,280	Percentage of fund members who are still unreconciled. These are either awaiting data from HMRC or further investigation by SBC/ITM
100%	20,942	

2.3 As at 22 August 2018 out of those 4,280 members unreconciled ITM passed a total of 1,773 to SBC for investigation.

- 1,280 of those members were updated as required and the information passed to ITM to forward to HMRC for further investigation.
- 495 of those members are under review by ITM. ITM have visited Scottish Borders Council to review the historic data to allow further responses to be made to HMRC.
- 2,505 are still awaiting data from HMRC.

2.4 Scottish Borders Council continues to receive monthly updates on the progress of the GMP Reconciliation exercise from ITM Limited and meet with the ITM Project Manager to discuss.

3 THE LOCAL GOVERNMENT PENSION SCHEME (SCOTLAND) REGULATIONS 2018

3.1 The SPPA issued new regulations on 1 June 2018 that have a number of inconsistencies and omissions that require rectification.

3.2 These new regulations have inter alia inadvertently revoked the Regulations introduced in 2014 mainly involving members who have met the rule of 85 and are looking to access their pension from age 55.

3.3 SPPA have issued a ”letter of comfort” from Kate Forbes, Minister for Public Finance and Digital Economy, Scottish Government – requesting administering authorities responsible for payment of pensions and other benefits to proceed on the basis that the previous regulations are still effective and any inconsistencies and omissions in the new 2018 Regulations will be addressed with retrospective effect.

4 AVC REVIEW

4.1 As agreed within the Business Plan approved in June work has been ongoing to review the current AVC provision and provider to the Fund. KPMG have undertaken a full review and found the provision meets the required code standards. The findings of this review were to be presented to the Joint Pension Fund and Board at this meeting.

4.2 Officers have however identified a Shared Cost scheme for AVC’s which would allow both employers and employees to be able to gain additional savings. This is currently being investigated and will form part of the final paper on AVC’s which will be presented to the Joint Pension Fund Committee and Board in December.

5 ACTUARY PROCUEMENT

5.1 It was agreed in the Business Plan in June to undertake a procurement exercise for procurement services, which has not been undertaken for some years. The Fund had previously agreed to use the Norfolk Framework for this procurement. There are 4 companies on the Framework including Barnett Waddingham.

5.2 The tender documents were published on the procurement portal on 24th August with the following timetable.

1	Further Competition Issued	24/08/2018
2	Deadline for Clarification questions	14/09/2018
3	Issue responses to clarifications	28/09/2018
3	Deadline for Further Competition responses	12/10/2018
4	Evaluation	19/10/2018
5	Presentation to Officers	13/11/2018
6	Issue intention to award letters	11/12/2018
7	Contract Award	01/01/2019

6 TRAINING OPPORTUNTIES

6.1 Investment training opportunity provided by LGC has been circulated on 9th August to all Members of the Board and Committee. Training is two half days on 23rd October and 24th October in Edinburgh. The following individuals have been registered to attend D Parker, S Mountford, S Scott, S Aitchison, C Stewart, E Barclay, M Drysdale and K Hughes.

6.2 The Pension and Lifetime Savings Association (PLSA) hold an annual investment conference in Edinburgh over 3 days. The dates for the next conference are 6-8 March 2019. To assist members of the Committee and Board to attend the Joint meeting on will be held at KPMGs offices in Edinburgh on the 7th March.

Author(s)

Name	Designation and Contact Number
Kirsty Robb Anthea Green	Pension & Investment Manager, 01835 825249 HR Shared Services Team Leader, 01835 826722

This page is intentionally left blank

STATEMENT OF RESPONSIBLE INVESTMENT

Report by Chief Financial Officer

PENSION FUND COMMITTEE & PENSION BOARD

13 September 2018

1 PURPOSE AND SUMMARY

1.1 The purpose of this note is to aid the Pension Fund Committee and Board in its discussion around responsible. It is proposed the attached paper will be developed into a Responsible Investment Policy for the Fund.

2 BACKGROUND

2.1 The Committee has an overriding fiduciary duty to maximise investment returns for the benefit of the Fund members. In doing so it is intended that the financial contributions required of Fund employers will be minimised.

2.2 Trustees of the Pension Fund also have a responsibility to ensure the Fund is undertaking its investment activities in a socially responsible way. This means the fund must be aware of its Environmental, social and governance (ESG) responsibilities.

2.3 Public interest in ESG has increased in recent years and there is a drive to increase the responsibilities placed upon Trustees for Environmental, Social and Governance issues. It is no longer acceptable for Trustees to do nothing on ESG.

2.4 Over the last year the Committee and Board have discussed ESG matters and agreed to review the ESG section of the Statement of Investment Principles. Upon review of good practice adopted by the Fund's Managers and other Pension Funds it has become clear that a separate Statement of Responsible Investment would fulfil the Fund's ESG responsibilities more appropriately. The document attached in Appendix 1 is a draft of a Statement of Responsible Investment for discussion at the meeting. This will be developed and presented to the Joint Committee and Board for final agreement at the December 2018 meeting.

Approved by
David Robertson Chief Financial Officer
Signature .....

Name	Designation and Contact Number
Kirsty Robb	Pensions and Investments Manager

1. STATEMENT OF RESPONSIBLE INVESTMENT

1.1 Scottish Borders Council Pension Fund's (SBCPF) overriding obligation is to act in the best interests of the scheme beneficiaries. In this fiduciary role SBCPF believes that environmental, social and corporate governance (ESG) issues can affect the financial performance of investments. Accordingly, SBCPF believes that these factors should be taken into account when managing the Scheme's assets, subject to the overriding fiduciary duty to maximise the financial return on investments. SBCPF has developed this Statement of Responsible Investment to outline how such issues are incorporated into its investment practices.

1.2 As a means of demonstrating its commitment to responsible investment practices, SBCPF has encouraged its Fund Managers to adopt the United Nations Principles of Responsible Investment (UNPRI).

1.3 SBCPF also believes its obligations to scheme beneficiaries can be met by taking an approach to environment, social and governance issues which uphold the highest standards and which seek to ensure that the funds minimises any harm to the environment and society, whilst ensuring the Fund is best placed to meet its future liabilities.

1.4 The Fund wishes to see its environmental foot-print minimised, its social responsibilities maximised and the highest standards of employee's relations and corporate governance maintained.

1.5 The Fund requires its investment managers to adhere to these standards in all their investments activities and plans to monitor these standards are upheld for the following set of overarching principles.

2 OVERARCHING PRINCIPLES

2.1 Environmental

2.1.1 SBCPF will seek via its investment activities to minimise its impact on the environment. It will seek to ensure our investments minimise any impact on pollution or climate change at a global and local level.

2.1.2 Where investment activities do have an impact on the environment, SBCPF will encourage managers to work with Companies to ensure they are acting in a responsible and sustainable way and are fully committed to ESG principles.

2.2 Social responsibility

2.2.1 SBCPF wishes to ensure that managers invest in companies who adhere to all applicable laws and standards. SBCPF wish to invest in companies who have good relations with the communities they are based in and wish to ensure that companies uphold principles of non-discrimination and fairness and avoidance of human risks violations.

2.2.2 Employee Relations – SBCPF through its fund managers we wish to ensure that none of investments use forced or child labour. That the highest safety standards are upheld for employees and where applicable employees are able to join trade unions and engage in collective bargaining.

2.3 Corporate Governance

2.3.1 SBCPF want to ensure that all our investments adhere to the highest standards of ethical conduct and the opportunities for bribery or corruptions or money laundering are minimised. The Fund wishes to ensure Executive Managers are remunerated and incentivise appropriately. The Fund will work through its fund managers to ensure that companies pay an appropriate share of their tax burden, in compliance with applicable law.

3 INVESTMENT DECISIONS

3.1 SBCPF delegates the selection of investments held to its fund managers and does not impose any investment restrictions in regard of social, ethical and environmental issues. SBCPF does not make any investment decisions specifically for social, ethical and environmental reasons.

3.2 SBCPF has instructed its active fund managers to take account of ESG considerations in their investment decision, provided the primary financial obligation is not compromised.

3.3 SBCPF will ensure that the fund managers it appoints are capable of appropriately considering ESG issues when making investment choices, it will monitor the managers' action in this area and will work with fund managers and the investment sector to ensure sufficient data is available to aid effective decision making.

3.4 SBCPF believes that, as a responsible investor, it has a legitimate interest in the management and corporate governance of the companies in which it invests and supports the use of voting as a means of expressing concern over environmental, social or governance (ESG) issues. The Fund seeks to improve corporate behaviour by maintaining effective shareholder oversight of the directors and company policies Voting is undertaken on SBCPF's behalf by its fund managers. Fund managers are expected to use fully exercise its right to vote at company meetings.

3.5 All active fund managers are encouraged to engage, on SBCPF's behalf, with those companies where ESG policies fall short of acceptable standards and where this is likely to have a detrimental effect on the long-term value of the company.

4 ESG MONITORING

4.1 The Fund believes that signature and adherence to the UNPRI codes provides an appropriate basis for demonstrating that companies comply with these principles. The Fund will encourage its fund managers to monitor the performance of companies which they are investing on the Funds behalf to comply with these principles. The fund will require an annual statement from its fund manager demonstrating how its investments meet these principles. The Fund will ask its

managers to provide a statement to show how managers have considered ESG issues in their investment decisions and provide evidence to how they have engaged with Companies to promote ESG issues and flagging areas for improvement where required.

4.2 In order to do this the policy will develop a scoring mechanism to assess how well each individual portfolio has performed in this area. It will not be the purpose of the policy to influence individual management investment decision however it will encourage the correct behaviours to ESG issues and allow managers to demonstrate their compliance.

4.2 The fund expects its managers to vote at all times in the best interest of the fund and in compliance with its ESG principles. The Fund supports the principles set out in the UK Stewardship code and will publish a statement of adherence to this code annually. The Fund will require its fund managers to provide copies of their statements to the stewardship code and will monitor their compliance with its principles.

This page is intentionally left blank

Document is Restricted

This page is intentionally left blank

Document is Restricted

This page is intentionally left blank

Document is Restricted

This page is intentionally left blank