

Pension Fund Committee AGENDA

DATE: Wednesday 9 March 2016

TIME: 6.30 pm

VENUE: Committee Room 5,
Harrow Civic Centre

MEMBERSHIP (Quorum 3 Councillors)

Chair: Councillor Adam Swersky

Councillors:

Keith Ferry
Norman Stevenson
Bharat Thakker (VC)

(Non-voting Co-optee): Mr H Bluston
Trade Union Observer(s): Mr J Royle - UNISON
Ms P Belgrave – GMB

Independent Advisers Colin Robertson
Richard Romain

Reserve Members:

1. Antonio Weiss
2. Nitin Parekh
1. Kanti Rabadia
2. Barry Macleod-Cullinane

Contact: Daksha Ghelani, Senior Democratic Services Officer
Tel: 020 8424 1881 E-mail: daksha.ghelani@harrow.gov.uk

AGENDA - PART I

1. ATTENDANCE BY RESERVE MEMBERS

To note the attendance at this meeting of any duly appointed Reserve Members.

Reserve Members may attend meetings:-

- (i) to take the place of an ordinary Member for whom they are a reserve;
- (ii) where the ordinary Member will be absent for the whole of the meeting; and
- (iii) the meeting notes at the start of the meeting at the item 'Reserves' that the Reserve Member is or will be attending as a reserve;
- (iv) if a Reserve Member whose intention to attend has been noted arrives after the commencement of the meeting, then that Reserve Member can only act as a Member from the start of the next item of business on the agenda after his/her arrival.

2. DECLARATIONS OF INTEREST

To receive declarations of disclosable pecuniary or non pecuniary interests, arising from business to be transacted at this meeting, from:

- (a) all Members of the Panel;
- (b) all other Members present.

3. MINUTES (Pages 5 - 14)

That the minutes of the meeting held on 25 November 2015 be taken as read and signed as a correct record.

4. PUBLIC QUESTIONS *

To receive any public questions received in accordance with Committee Procedure Rule 17 (Part 4B of the Constitution).

Questions will be asked in the order notice of them was received and there be a time limit of 15 minutes.

[The deadline for receipt of public questions is 3.00 pm, Friday 4 March 2016. Questions should be sent to publicquestions@harrow.gov.uk

No person may submit more than one question].

5. PETITIONS

To receive petitions (if any) submitted by members of the public/Councillors under the provisions of Committee Procedure Rule 15 (Part 4B of the Constitution).

6. DEPUTATIONS

To receive deputations (if any) under the provisions of Committee Procedure Rule 16 (Part 4B) of the Constitution.

- 7. INFORMATION REPORT - ACTUARIAL VALUATION 2016** (Pages 15 - 20)
Report of the Director of Finance.
- 8. INFORMATION REPORT - EXTERNAL AUDIT PLAN 2015-16** (Pages 21 - 40)
Report of the Director Finance.
- 9. INFORMATION REPORT - LOCAL GOVERNMENT PENSION SCHEME: REVOKING AND REPLACING THE LOCAL GOVERNMENT PENSION SCHEME (MANAGEMENT AND INVESTMENT OF FUNDS) REGULATIONS 2009** (Pages 41 - 74)
Report of the Director of Finance.
- 10. INFORMATION REPORT - POOLING CRITERIA AND GUIDANCE AND LONDON PENSIONS COLLECTIVE INVESTMENT VEHICLE** (Pages 75 - 134)
Report of the Director of Finance.
- 11. INFORMATION REPORT - ANNUAL REVIEW OF INTERNAL CONTROLS AT FUND MANAGERS** (Pages 135 - 160)
Report of the Director of Finance.
- 12. INFORMATION REPORT - ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES IN PENSION FUND INVESTMENT** (Pages 161 - 200)
Report of the Director of Finance.
- 13. WORK PROGRAMME FOR 2016-17** (Pages 201 - 204)
Report of the Director of Finance.
- 14. INFORMATION REPORT - PERFORMANCE OF FUND MANAGERS FOR QUARTER ENDED 31 DECEMBER 2015 AND VALUATION AT 31 JANUARY 2016** (Pages 205 - 210)
Report of the Director of Finance.
- 15. DATES OF PENSION FUND COMMITTEE MEETINGS 2016/17**
Tuesday 21 June 2016 at 6.30pm
Tuesday 6 September 2016 at 6.30pm
Tuesday 22 November 2016 at 6.30pm
Tuesday 7 March 2016 at 6.30pm.
- 16. ANY OTHER URGENT BUSINESS**
Which cannot otherwise be dealt with.

17. EXCLUSION OF PRESS AND PUBLIC

To resolve that the press and public be excluded from the meeting for the following item of business, on the grounds that it involves the likely disclosure of confidential information in breach of an obligation of confidence, or of exempt information as defined in Part I of Schedule 12A to the Local Government Act 1972:

<u>Agenda Item No</u>	<u>Title</u>	<u>Description of Exempt Information</u>
18.	Information Report - Investment Manager Monitoring	Information under paragraph 3 of Part I of Schedule 12A to the Local Government Act 1972, relating to the financial or business affairs of any particular person (including the authority holding that information).

AGENDA - PART II

18. INFORMATION REPORT - INVESTMENT MANAGER MONITORING (Pages 211 - 264)

Report of the Director of Finance.

[Please note that Aon Hewitt, Advisers to the Fund, will be attending this meeting.]

* DATA PROTECTION ACT NOTICE

The Council will audio record item 4 (Public Questions) and will place the audio recording on the Council's website, which will be accessible to all.

[**Note:** The questions and answers will not be reproduced in the minutes.]

PENSION FUND COMMITTEE

MINUTES

25 NOVEMBER 2015

Chair:	* Councillor Adam Swersky	
Councillors:	* Keith Ferry	* Bharat Thakker
	* Kanti Rabadia (1)	
Co-optee (Non-voting):	* Howard Bluston	* John Royle Pamela Belgrave
Independent Advisers:	* Colin Robertson	* Richard Romain

[Note: Other Attendance: (1) John Royle attended in an observer role, as the representative of Harrow UNISON;

(2) Honorary Alderman Richard Romain and Colin Robertson attended as Independent Advisers to the Committee.

(3) Colin Cartwright and Gayathri Varatharajan of Aon Hewitt attended in an advisory role, as the Council's Investment Adviser.

(4) Hugh Grover, Chief Executive - London Collective Investment Vehicle, and Richard Harbord, Chair of the Pension Board, attended the meeting as observers. They participated in the meeting on specific items on the agenda.]

* Denotes Member present

(1) Denotes category of Reserve Member

97. Welcome

The Chair welcomed Hugh Grover, London Collective Investment Vehicle, and Richard Harbord, Independent Chair of the Council's Pension Board, to their first meeting of the Pension Fund Committee.

98. Attendance by Reserve Members

RESOLVED: To note the attendance at this meeting of the following duly appointed Reserve Members:-

Ordinary Member

Reserve Member

Councillor Norman Stevenson

Councillor Kanti Rabadia

99. Declarations of Interest

RESOLVED: To note that the following interests were declared:

All Agenda Items

Councillor Kanti Rabadia, a Reserve Member on the Committee, declared a non-pecuniary interest in that his wife was a member of the Local Government Pension Scheme. He would remain in the room whilst the matters were considered and voted upon.

Howard Bluston, a non-voting co-optee, declared a non-pecuniary interest in that he was Chair of Edward Harvist Charity, which was managed by BlackRock Investment Management. He added that he had regular dealings with Aon Hewitt, the Council's Investment Adviser, and that he had represented the Committee at the Local Authority Pension Fund Forum. He would remain in the room whilst the items were discussed and make contributions as a non-voting co-optee on the Committee.

100. Minutes

RESOLVED: That the minutes of the ordinary meeting held on 8 September 2015 and the special meeting held on 5 November 2015 be taken as read and signed as a correct record.

101. Public Questions, Petition and Deputations

RESOLVED: To note that no public questions were put, or petitions or deputations received at this meeting.

RESOLVED ITEMS

102. London Pensions Collective Investment Vehicle - Update

The Committee received an information report of the Director of Finance, which summarised the progress made in setting the London Local Government Pension Scheme Collective Investment Vehicle (CIV) and the Harrow Fund's involvement therein.

The Director of Finance referred to the presentation made by Hugh Grover of London's Collective Investment Vehicle (CIV) prior to the meeting and invited

him to participate in the discussion on this item. She referred to the DCLG consultation document on the possible replacement of the “Management and Invest of Funds” regulations issued on the day of the Committee and of the need to respond before the next meeting. She undertook to circulate a draft reply to members of the Committee prior to the Christmas break. A formal response to the DCLG would follow in the New Year.

An Independent Adviser suggested a discussion at the London Leaders’ Committee to ensure a ‘political’ reply.

Mr Grover answered questions from the Committee as follows:

- it was entirely for the boroughs to decide how the CIV ought to evolve. The government’s strategy would also need to be examined in detail. Aon Hewitt confirmed that the boroughs would have the responsibility to monitor the CIV and oversee its functions;
- the CIV would develop overtime and quarterly reports would be submitted to the boroughs. Additionally, the engagement of the Fund Managers would need to be worked up. The latter would help ensure a collective focus on their performance and a system would need to be developed to ensure that this happened;
- the DCLG consultation document suggested that LGPS funds would increasingly be required to invest in collective vehicles and whilst no deadline had yet been set, the government had indicated a deadline of 2020/21;
- it was his personal view that whilst boroughs could continue working outside of the CIV, the changing world made it essential to participate in the CIV. It was important for discussion to take place within the CIV in light of the consultation document. A collective view of the various other bodies was also essential, including how to respond to the consultation.

RESOLVED: That the report be noted and the Director of Finance circulate a draft reply on the DCLG Consultation entitled “Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 by Christmas 2015 for members’ comments.

103. Options for Liability Driven Investment Strategy

The Committee received a report of the Director of Finance, asking members to consider a report from Aon Hewitt, Council’s Investment Adviser, which set out options for taking forward the consideration of a Liability Driven Investment Strategy (LDI).

Colin Cartwright of Aon Hewitt made reference to the decision made at the 8 September 2015 meeting of the Committee that the status quo, a 13% Bond allocation invested in a combination of Corporate Bonds and index-linked Gilts, be retained in relation to the Fund’s Bond portfolio and that Aon Hewitt be requested to provide guidance on the catalysts that would trigger a move

to an LDI Strategy with Option 2 being the preferred Option. He outlined the four triggers set out in the report and added a fifth, as follows:

- simple triggers which related to long term bond yields (ie the cost of purchasing bonds);
- affordability which related to the Pension Fund's funding level;
- price/value which related to medium term asset allocation (MTAA) views on long term yields;
- Harrow specific events;
- when Liability Driven Investment (LDI) became available in the Collective Investment Vehicle (CIV).

A discussion ensued as follows:

- whether interest/inflation rates could be considered as triggers. Mr Cartwright replied that his report concentrated on nominal triggers particularly in relation to simple and price/value triggers but both inflation and interest rates could be considered and he offered to provide a report back;
- whether both hard (where action is taken automatically) and soft triggers (where action needs to be considered) could be considered. Mr Cartwright explained the important features of the triggers he offered to provide a report back on soft triggers.

The Chair highlighted the need for a definitive view on when the move to an LDI Strategy ought to take place and was of the view that the timing of the hedge was not a strategic decision but accepted that various events would trigger a discussion. A view that this matter needed to be monitored rather than placed as a rolling item on the agenda was expressed. Mr Cartwright suggested that he would recommend a move of the 13% currently in Bonds into LDI with either BlackRock or another investment company. He had not yet considered the triggers for its unwinding.

An officer stated that a concise joint report with Aon Hewitt on funding levels would be submitted to the Committee once he had had examined the quarterly returns from Hyman Robertson, Council's Actuary/Adviser, and that such reports would be presented on a quarterly basis.

RESOLVED: That, having considered the report from Aon Hewitt on "Triggers to re-consider a LDI Solution", the following be agreed to take forward the consideration of LDI:

- a short report on funding levels be submitted to the next meeting of the Committee and thereafter on a quarterly basis.

104. Environmental, Social and Governance Issues in Pension Fund Investment

The Committee received a report of the Director of Finance, setting out the recent developments in the context of environmental, social and governance issues in Pension Fund investments and recommended the enhancement of the Fund's activities in this area.

An officer provided the background to the report and referred to the presentation made at the September 2015 meeting in this regard from a ShareAction, a charity that promoted responsible investment. The officer drew attention to the external legal opinions set out in the report and highlighted the various levels at which the Fund could promote environmental, social and governance (ESG) issues, details of which were set out at paragraph 15 of the report. He highlighted the difficulties faced in satisfying the principles for responsible investment and referenced the need to have Member/Officer representation at the Local Authority Pension Fund Forum at which the Co-opted member had represented the Committee.

Mr Cartwright of Aon Hewitt highlighted the benefits of the Local Authority Pension Fund Forum which actively engaged with various industries, such as the tobacco industry, by making them examine litigation and reputational risks which assisted Fund Managers in their investments. He added that resolutions (1) and (2) should also apply to Aon Hewitt.

A Member referred to the role of the Committee which was to protect investments in order to obtain the best returns. As a result, an options exercise/scenario would have been helpful.

An Independent Member suggested further amendments within the Statement of Investment Principles, which were agreed. He also suggested the need for admitted bodies to be involved. A Member was of the view that the Pension Board might wish to look into the latter suggestion. The Chair was of the view that beneficiaries and representatives of beneficiaries ought to be considered by the Pension Board.

The Committee noted that requests about ESG had been received under the Freedom of Investment Act. The Chair drew attention to the report of the Law Commission at appendix 2 to the report and the need to reflect on it in relation to the long term risks, views and values to the beneficiaries. It was noted that the government did not endorse the Law Commission's view.

RESOLVED: That

- (1) investment managers and Aon Hewitt, Council's Investment Adviser, be asked to advise whether they had signed up to UN Principles for Responsible Investment (PRI);
- (2) investment managers and Aon Hewitt, Council's Investment Adviser, be asked to confirm that they had signed up to "The UK Stewardship Code" and to provide reports on their engagement and voting actions;

- (3) in the light of the responses received to resolutions (1) and (2) above, the Fund consider further whether to sign up to “The UK Stewardship Code” in its own right following the receipt of a further report setting out any conditions in relation to appendix 3 of the report and concerns about creating an infrastructure dependent on resolutions (1) and (2) above;
- (4) the Fund take a more active involvement in the Local Authority Pension Fund Forum by attending meetings at a Member or officer level and by more specifically associating itself with various initiatives;
- (5) within the Statement of Investment Principles the current paragraph on “social, environmental or ethical considerations” be amended in accordance with paragraph 27 of the report and those made at the meeting, as follows:

“The Council recognises that it has a paramount duty to seek to obtain the best possible return on the Fund’s investments taking into account a properly considered level of risk. As a general principle it considers that the long-term financial performance of a country/asset in which it invests is likely to be enhanced if good practice is followed in environmental, social and governance activities.

All the Fund’s investments are managed by external fund managers mostly within pooled funds. Currently, one is passively managed and one is specifically invested in emerging markets. The Council recognises the constraints inherent in this policy. Nevertheless it expects its external fund managers, acting in the best financial interests of the Fund, to consider, amongst other factors, the effects of environmental, social and other issues on the performance of countries and assets in which they invest.

The Council expects its external fund managers to have signed up to “The UK Stewardship Code” and to report regularly on their compliance with the Code and other relevant environmental, social and governance principles.”

- (6) the Pension Board be requested to consider the need for admitted bodies to be involved in consideration of the importance of ESG issues and to what extent the views of the beneficiaries and representatives of beneficiaries should be taken into account.

105. Statement of Investment Principles

The Committee received a report of the Director of Finance, which requested consideration and approval of a draft revised Statement of Investment Principles. An officer highlighted the changes made.

An Independent Member highlighted the need to make changes as discussed at agenda item 9 (Minute 104 refers) and that paragraphs 4.3 and 4.8 of appendix 1 ‘Statement of Investment Principles’ to the report also required amending, as follows:

paragraph 4.3 to state ‘ ... **external** fund managers ...’
paragraph 4.8 to state ‘Stock lending is **allowed** ...’

RESOLVED: That the revised Statement of Investment Principles be approved, subject to the amendments set out in the preamble above and those set out under resolution 5 of Minute 104.

106. Benchmarking and Key Performance Indicators

The Committee received an information report of the Director of Finance on a request from the Local Government Pension Scheme - Scheme Advisory Board - that each administering authority completes a pro-forma providing information on key performance indicators. The report also advised the Committee of the return sent to the Scheme Advisory Board.

An officer reported that there was currently no intention to produce league tables and he was confident about the scorings given.

RESOLVED: That the report be noted.

107. Meeting of Pension Board on 2 November 2015

The Committee received an information report of the Director of Finance regarding the matters considered by the Pension Board at their meeting on 2 November 2015 and of the most significant issues raised by them.

The Chair of the Pension Board addressed the Committee and outlined the interests of the Board which were: performance of the Fund, including key performance indicators (KPIs) and management costs. He added that the Board would continue to make representations on the need to have access to ‘confidential’ reports considered by the Committee as the practice on access varied from one authority to another. The Board was of the view that, in order for it to do its ‘business’ effectively, it needed to meet more frequently and that representations in this regard would continue as the two meetings allocated were insufficient.

The Chair of the Pension Board added that training was provided and that a high level of knowledge was required from the Board’s members.

An Independent Adviser to the Committee recognised that the Board would need to meet frequently and asked Members to make representations about accessibility to ‘confidential’ reports considered by the Committee.

The Chair of the Pension Fund Committee cited the example of the agenda for this meeting and stated that a concerted effort had been made by officers to ensure that, where possible, the reports considered by the Committee were available for public access and that ‘confidential’ reports were limited in number. In light of the practice in other local authorities and the statutory nature of the Pension Board, the Chair asked officers for further legal advice on the ability of the Board to access ‘confidential’ reports.

RESOLVED: That the report be noted.

108. Work Programme for 2015-16 and 2016-17

The Committee received its a draft work programme for the remainder of financial years 2015-16 and 2016-17 for approval.

The need to include additional reports discussed at this meeting was noted and a discussion on whether a report on the Collective Investment Vehicle (CIV) ought to be more frequent ensued.

Dates of future meetings of the Committee were noted, including that they were subject to Cabinet's approval in January 2016.

RESOLVED: That

- (1) the Work Programme for the period up to March 2017 be agreed, subject to the inclusion of the following additional reports:
 - Environmental, Social and Governance (ESG) issues in Pension Fund Investment (Minute 104 refers);
 - Liability Driven Investments (LDIs) (Minute 103 refers);
 - Collective Investment Vehicle (CIV) (Minute 102 refers) to be reported at each meeting;
- (2) a training session be arranged during the summer of 2016 in relation to the transfer of Funds.

109. London Borough of Harrow Pension Fund: Annual Report and Financial Statements for the year ended 31 March 2015

The Committee received a report of the Director of Finance on the audited Pension Fund Annual Report and Financial Statements for the year ending 31 March 2015.

An officer highlighted aspects of the report and reported that the auditors had required no figures to be changed.

RESOLVED: That having considered the report of the of the External Auditor on matters arising from the audit of the Pension Fund Annual Report and Financial Statements for the year ended 31 March 2015, the audited Pension Fund Annual Report and Financial Statements for the year ended 31 March 2015 be approved.

110. Performance of Fund Managers for Quarter Ended 30 September 2015 and Valuation at 31 October 2015

The Committee received an information report of the Director of Finance setting out the performance of the investment managers and of the overall Fund for the quarter, year and three years ending 30 September 2015 and the valuation at 31 October 2015.

The Committee also received an updated Appendix 2 'Investment Performance – 30 September 2015', which was tabled at the meeting. An officer added that the returns had recently improved.

Members noted that Aon Hewitt would be reviewing the performance of Oldfield Partners LLP and inform members of the outcome. It was noted that relative performance of most of the investment managers was strong.

RESOLVED: That the report be noted.

111. Other Business

Pooling of Pension Funds

A Member raised concerns over perceptions that the government may be seeking to reduce the role of administering authorities in the management of their Funds by leading them towards very large pooled fund and infrastructure investments.

A short discussion also ensued on the government's role as a funder of last resort.

112. Exclusion of the Press and Public

RESOLVED: That, in accordance with Part I of Schedule 12A to the Local Government Act 1972, the press and public be excluded from the meeting for the following item for the reason set out below:

<u>Item</u>	<u>Title</u>	<u>Reason</u>
18.	Investment Manager Monitoring	Information under paragraph 3 (contains information relating to the financial or business affairs of any particular person (including the authority holding that information)).

113. Investment Manager Monitoring

The Committee received a confidential information report which set out Aon Hewitt's quarterly report on Harrow's investment managers and noted that all managers were rated either "Buy" or "Qualified".

Colin Cartwright of Aon Hewitt referred to an earlier discussion on the need to review the performance of Oldfield Partners LLP. It was noted that the cash held by Longview was not considered to be an issue. A short discussion on benchmarking ensued and it was

RESOLVED: That the report be noted.

(Note: The meeting, having commenced at 6.44 pm, closed at 8.33 pm).

(Signed) COUNCILLOR ADAM SWERSKY
Chair

**REPORT FOR: PENSION FUND
COMMITTEE**

Date of Meeting:	9 March 2016
Subject:	Information Report – Actuarial Valuation 2016
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	Appendix: Regulation 62 of Local Government Pension Scheme Regulations 2013

Section 1 – Summary

This report advises the Committee of the statutory requirement for the triennial valuation of the Pension Fund during 2016 and invites them to receive a presentation from the Actuary, Hymans Robertson LLP.

For Information

Section 2 – Report

1. As required by Regulation 62 of the Local Government Pension Scheme Regulations 2013, every three years an actuarial valuation of the Pension Fund is carried out. The last valuation was carried out in 2013 with the results implemented from 1 April 2014. Another valuation is now due and the Council has appointed the Actuary, Hymans Robertson LLP, as currently led by the partner, Ms Gemma Sefton, to complete the work.
2. A copy of the full text of the Regulation is attached as Appendix I. Some of the main features are as follows:

An administering authority must obtain—

- (a) an actuarial valuation of the assets and liabilities of each of its pension funds as at 31st March 2016 and on 31st March in every third year afterwards;*
- (b) a report by an actuary in respect of the valuation; and*
- (c) a rates and adjustments certificate prepared by an actuary.*

Each of those documents must be obtained before the first anniversary of the date (“the valuation date”) as at which the valuation is made or such later date as the Secretary of State may agree.

The actuary must have regard to—

- (a) the existing and prospective liabilities arising from circumstances common to [the employers];*
- (b) the desirability of maintaining as nearly constant a common rate as possible;*
- (c) the current version of the administering authority’s funding strategy statement; and*
- (d) the requirement to secure the solvency of the pension fund and the long term cost efficiency of the Scheme, so far as relating to the pension fund.*

3. On 29 January the Director of Finance and several other officers met the Actuary and agreed a timetable.
4. Ms Sefton has been invited to make a presentation covering some of the most significant aspects of the valuation and the Committee are invited to receive this presentation and note the report.

Financial Implications

5. Whilst, clearly, the results of the valuation have a major impact on the management of the Pension Fund and the contributions from the General Fund there are no financial implications arising directly from this report.

Risk Management Implications

6. The Pension Fund has its own risk register which includes risks arising in connection with the triennial valuation.

Equalities implications

7. There are no direct equalities implications arising from this report.

Council Priorities

9. Whilst the financial health of the Pension Fund and the employer's contribution affects the resources available for the Council's priorities there are no impacts arising directly from this report.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert



Director of Finance

Date: 25 February 2016

Ward Councillors notified:

NO

Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager
0208 424 1450

Background Papers - None

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Local Government Pension Scheme Regulations 2013, Regulation 62

Actuarial valuations of pension funds

62.—(1) An administering authority must obtain—

- (a) an actuarial valuation of the assets and liabilities of each of its pension funds as at 31st March 2016 and on 31st March in every third year afterwards;
- (b) a report by an actuary in respect of the valuation; and
- (c) a rates and adjustments certificate prepared by an actuary.

(2) Each of those documents must be obtained before the first anniversary of the date (“the valuation date”) as at which the valuation is made or such later date as the Secretary of State may agree.

(3) A report under paragraph (1)(b) must contain a statement of the demographic assumptions used in making the valuation; and the statement must show how the assumptions relate to the events which have actually occurred in relation to members of the Scheme since the last valuation.

(4) A rates and adjustments certificate is a certificate specifying—

- (a) the primary rate of the employer’s contribution; and
- (b) the secondary rate of the employer’s contribution, for each year of the period of three years beginning with 1st April in the year following that in which the valuation date falls.

(5) The primary rate of an employer’s contribution is the amount in respect of the cost of future accruals which, in the actuary’s opinion, should be paid to a fund by all bodies whose employees contribute to it so as to secure its solvency, expressed as a percentage of the pay of their employees who are active members.

(6) The actuary must have regard to—

- (a) the existing and prospective liabilities arising from circumstances common to all those bodies;
- (b) the desirability of maintaining as nearly constant a common rate as possible;
- (c) the current version of the administering authority’s funding strategy mentioned in regulation 58 (funding strategy statements); and
- (d) the requirement to secure the solvency of the pension fund and the long term cost efficiency of the Scheme, so far as relating to the pension fund.

(7) The secondary rate of an employer’s contributions is any percentage or amount by which, in the actuary’s opinion, contributions at the primary rate should, in the case of a Scheme employer, be increased or reduced by reason of any circumstances peculiar to that employer.

(8) A rates and adjustments certificate must contain a statement of the assumptions on which the certificate is given as respects—

- (a) the number of members who will become entitled to payment of pensions under the provisions of the Scheme; and
- (b) the amount of the liabilities arising in respect of such members, during the period covered by the certificate.

(9) The administering authority must provide the actuary preparing a valuation or a rates and adjustments certificate with the consolidated revenue account of the fund and such other information as the actuary requests.

**REPORT FOR: PENSION FUND
COMMITTEE**

Date of Meeting: 9 March 2016

Subject: Information Report – External Audit Plan 2015-16

Responsible Officer: Dawn Calvert, Director of Finance

Exempt: No

Wards affected: All

Enclosures: Appendix: External Audit Plan 2015/16 - KPMG

Section 1 – Summary

The report advises the Committee of the external audit plan for 2015-16 as presented by KPMG to Governance, Audit, Risk Management and Standards Committee on 28 January 2016.

FOR INFORMATION

Section 2 – Report

1. The Council has received the External Audit Plan 2016/16 as prepared by KPMG and presented to Governance, Audit, Risk Management and Standards Committee on 28 January 2016. The Plan, which includes the audit of the Pension Fund, is attached as the appendix to this report.

2. Broadly, the Plan covers:

- Headlines
- Introduction
- Financial Statements and Audit Planning
- Value for Money Arrangements

3. In addition to the overall audit of the Fund the auditors have made the following specific points:

- Materiality - £7m (page 1 of Plan)
- Uncorrected omissions to be reported by the Auditor - £300,000 (page 1 of Plan)
- Significant risk – Investment valuation (pages 1 and 4 of Plan)
- Other areas of audit focus – Pension liability assumptions; Calculation of benefits (pages 1, 5 and 6 of Plan)

Financial Implications

4. Whilst, clearly, the annual audit concentrates largely on the financial state of the Pension Fund there are no financial implications arising directly from this report.

Risk Management Implications

5. The Pension Fund has its own risk register which includes all the risks identified. The annual audit assists in the management of the risks but no implications arise directly from this report.

Equalities implications

6. There are no direct equalities implications arising from this report.

Council Priorities

7. Whilst the financial health of the Pension Fund directly affects the level of employer contribution which, in turn, affects the resources available for the Council's priorities there are no impacts arising directly from this report.

Section 3 - Statutory Officer Clearance

Name Dawn Calvert Director of Finance

Date: 25 February 2016

Ward Councillors notified:

NO

Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager
0208 424 1450

Background Papers - None

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External Audit Plan 2015/2016

London Borough of Harrow and Pension Fund

14 January 2016

Financial Statement Audit



There are no significant changes to the Code of Practice on Local Authority Accounting in 2015/16, which provides stability in terms of the accounting standards the Authority need to comply with.

This plan sets out our approach for auditing the Authority financial statements and the Pension Fund financial statements.

Materiality

Materiality for planning purposes has been set at **£6 million** for the Authority and **£7 million** for the Pension Fund.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at **£300,000** for the Authority and for the Pension Fund.

Significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error for the Authority have been identified as:

- Management override of controls,
- Fraudulent revenue recognition; and
- Valuation of Property, Plant and Equipment.
- Investment valuation (Pension Fund)

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding have been identified as:

- Financial Planning,
- Pension Liability assumptions;

- Grant income recognition; and
- Calculation of benefits (Pension Fund).

See pages 4 to 6 for more details.

Value for Money Arrangements work



The National Audit Office has issued new guidance for the VFM audit which applies from the 2015/16 audit year. The approach is broadly similar in concept to the previous VFM audit regime, but there are some notable changes:

- There is a new overall criterion on which the auditor's VFM conclusion is based; and
- This overall criterion is supported by three new sub-criteria.

Our risk assessment is ongoing and we will report VFM significant risks during our audit.

See pages 8 to 10 for more details.

Logistics



Our team is:

- Andy Sayers, Partner
- Emma Larcombe, Manager
- Jess Hargreaves, Assistant Manager

More details are on **page 13**.

Our work will be completed in four phases from January to September and our key deliverables are this Audit Plan and a Report to Those Charged with Governance as outlined on **page 12**.

Our fee for the audit is £150,725 for the Authority and £21,000 for the Pension Fund see **page 11**.

Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2015/16 provided in April 2015, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014 and the National Audit Office's Code of Audit Practice.

Our audit has two key objectives, requiring us to audit/review and report on your:

- *Financial statements (including the Annual Governance Statement):* Providing an opinion on your accounts; and
- *Use of resources:* Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

This plan considers both the Authority financial statements as well as the Pension Fund financial statements.

audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their help and co-operation throughout our initial work with the Authority.

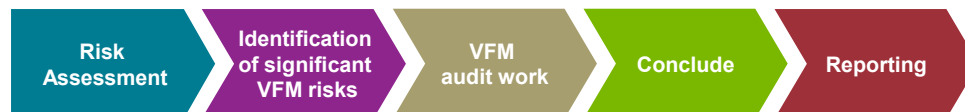
Financial Statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. Appendix 1 provides more detail on the activities that this includes. This report concentrates on the Financial Statements Audit Planning stage of the Financial Statements Audit.



Value for Money Arrangements Work

Our Value for Money (VFM) Arrangements Work follows a five stage process which is identified below. Page 7 provides more detail on the activities that this includes. This report concentrates on explaining the VFM approach for the 2015/16. As this is our first year as auditors our VFM risk assessment is ongoing and we report any matters in this regard as the audit progresses and/or in our Report to Those Charged with Governance.



Financial Statements Audit Planning

Our planning work takes place during December 2015 to February 2016. This involves the following key aspects:

- Risk assessment;
- Determining our materiality level; and
- Issuing this audit plan to communicate our audit strategy.

Risk assessment

Professional standards require us to consider two standard risks for all organisations. We are not elaborating on these standard risks in this plan but consider them as a matter of course in our audit and will include any findings arising from our work in our ISA 260 Report. These risks are:

- 28 Management override of controls – Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.
- Fraudulent revenue recognition – We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

The diagram opposite identifies, significant risks and other areas of audit focus, which we expand on overleaf. The diagram also identifies a range of other areas considered by our audit approach. Areas relating to the Pension Fund are identified by PF.

As this is our first year as auditors our risk assessment will be kept under review and we will report any amendments as the audit progresses and/or in our Report to Those Charged with Governance.



Keys: ● Significant risk ● Other area of audit focus ● Example other areas considered by our approach



Significant Audit Risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error.

Valuation of PPE

Issue:

In 2014/15 the Authority reported Property, Plant and Equipment in its financial statements of £871m. The Authority must exercise judgement in determining the fair value of the different classes of assets held and the methods used to ensure that the carrying values recorded each year reflect those fair values.

Given the materiality in value and the judgement involved in determining the carrying amounts of assets we consider this to be a significant audit risk for 2015/16.

Approach:

We will undertake detailed testing of Property, Plant and Equipment as part of our final accounts audit, including specific detailed testing of the asset valuation. We will critically analyse the valuation methodology adopted by the Authority's valuer and benchmark this against national indices in order to confirm that the valuation is reasonable.

We will consider the basis on which the valuation has been carried out to ensure it is in line with *The Code of Practice on Local Authority Accounting in the United Kingdom 2015-6*. We will carry out detailed testing to ensure that revaluation gains and losses have been correctly reflected in the financial statements.

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Valuation of investments – Pension Fund

Issue:

At the 31 March 2015 the Pension Fund had investments of £670 million. The investment portfolio includes private equity and derivatives both of which are complex to value and, in the case of private equity, include a degree of judgement from the Fund Manager. Given the complexity surrounding the investment portfolio we consider this to be a significant audit risk for 2015/16.

Approach:

We will undertake detailed testing of investments as part of our final accounts audit, including assessing the design and operation of controls in place, obtaining independent confirmations from Fund Managers to verify year end balances, undertake substantive testing over sales and purchases made in the year, reviewing year on year movements and comparing performance to known benchmarks and if appropriate engaging our specialist valuation team.



Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Financial Planning

Issue:

The Authority has significant savings targets to achieve in the coming years. The 15/16 MTFP taken to the February 2015 Council meeting highlighted a funding gap of c.£23 million for 2016/17 and c.£15 million and c.£14 million in 2017/18 and 2018/19 respectively, we are aware that work has been done on identifying savings to address these funding gaps with a balance budget being proposed for 2016/17. In addition the Authority has low general fund reserves of £10 million. These savings need to be achieved in an environment where external funding is decreasing and pressure on service is increasing. The Authority needs to ensure that it has robust financial planning arrangements in place.

Approach:

In conjunction with our VFM work we will critically assess the controls the Authority has in place to ensure a sound financial standing, specifically that its Medium Term Financial Plan has duly taken into consideration the potential funding reductions and that it is sufficiently robust to ensure that the Authority can continue to provide services effectively.

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Pension Liability assumptions

Issue:

The Authority is required to provide the value of the pension fund asset/liability as at the reporting date, taking into account numerous and complex assumptions. This creates a risk that the financial statements may be materially misstated.

Small changes to these assumptions can have a large effect on the reported value and the Authority should ensure that the information provided to the actuary is up to date and complete to ensure the values reported in the accounts take into account all requisite information.

Approach:

We will review the instructions provided to the actuary and the information supplied to the Actuary to come to their conclusions. We will also undertake tests of detail on the accounting entries performed as a result of the information returned from the actuary.

**Other areas of audit focus****Grant income recognition****Issue:**

In 2014/15 the total government grants and contributions recognised was £405 million, and total capital grants deferred was £23.4 million. Accounting for grant income is complex as the basis for revenue recognition in the financial statements will vary depending on the individual conditions associated with each grant. In addition Management must apply judgement to determine if such conditions are attached to a grant and if they have been met.

Approach:

We will perform substantive testing over a sample of revenue and capital grants received during the year. We will review grant correspondence and assess if the Authority has recognised the income in accordance with the CIPFA Code and grant agreement.

Calculation of benefits – Pension Fund**Issue:**

3 calculation of benefits can be complex. In 2014/15 a total of £32 million was paid out by the fund. Given the quantity and complexity of these calculations there is a risk of 1 statement.

Approach:

We will review the process and controls in place over the calculation of benefits to ensure that they are robust. In addition we will perform substantive testing of the calculation of benefits to confirm their accuracy.



Materiality

We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

For the Authority, materiality for planning purposes has been set at £6 million for the Authority's standalone accounts, which equates to just over 1 percent of gross expenditure.

For the Pension Fund, materiality for planning purposes has been set at £7 million.

design our procedures to detect errors in specific accounts at a lower level of precision.

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Reporting to the Governance, Audit, Risk Management and Standards Committee

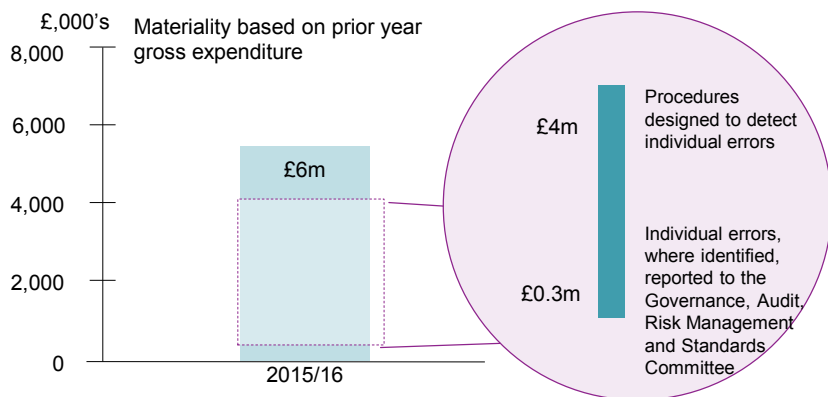
Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Governance, Audit, Risk Management and Standards Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260(UK&I) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £300,000.

Similarly in the context of the Pension Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £300,000.

If management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Governance, Audit, Risk Management and Standards Committee to assist it in fulfilling its governance responsibilities.



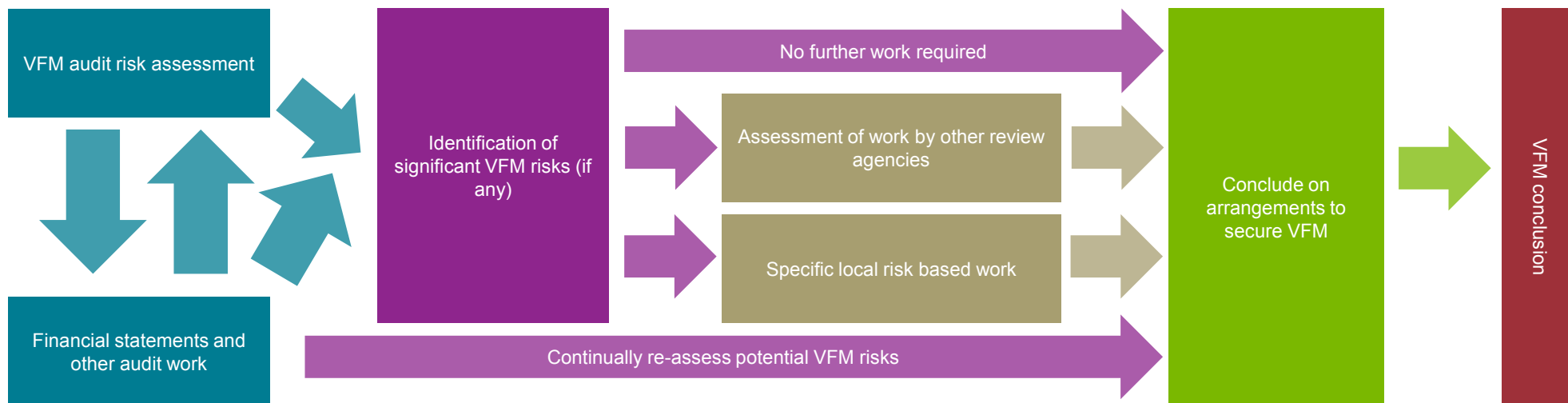
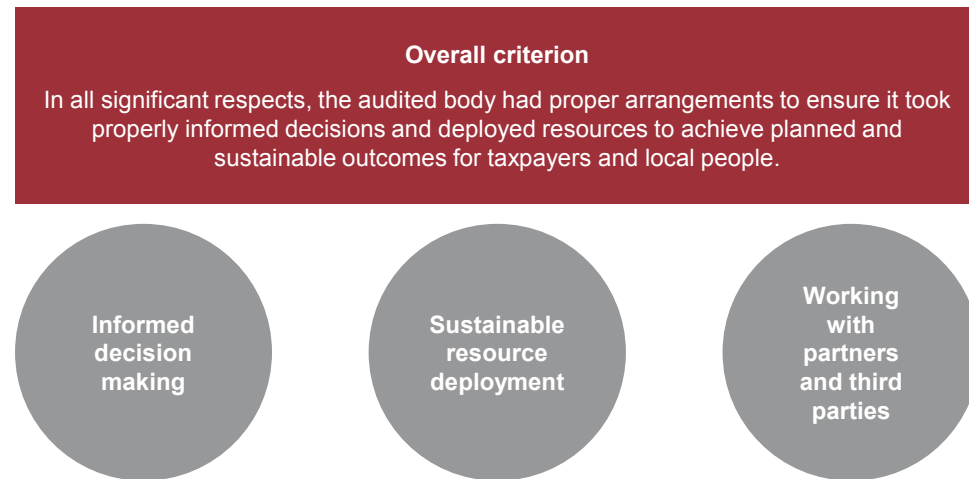
Background to approach to VFM work

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria. These sub-criteria provide a basis to our VFM work at the Authority. The diagram to the right shows the details of the criteria.

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VFM audit stage	Audit approach
VFM audit risk assessment	<p>We consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Authority. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the <i>Code of Audit Practice</i>.</p> <p>In doing so we consider:</p> <ul style="list-style-type: none"> ■ The Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks; ■ Information from the Public Sector Auditor Appointments Limited VFM profile tool; ■ Evidence gained from previous audit work, including the response to that work; and ■ The work of other inspectorates and review agencies.
34 Packages with financial statements and other audit work	<p>There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Authority's organisational control environment, including the Authority's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities.</p> <p>We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit.</p>
Identification of significant risks	<p>The Code identifies a matter as significant '<i>if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.</i>'</p> <p>If we identify significant VFM risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including:</p> <ul style="list-style-type: none"> ■ Considering the results of work by the Authority, inspectorates and other review agencies; and ■ Carrying out local risk-based work to form a view on the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.



VFM audit stage	Audit approach
<p>Assessment of work by other review agencies</p> <p>and</p> <p>Delivery of local risk based work</p>	<p>Depending on the nature of the significant VFM risk identified, we may be able to draw on the work of other inspectorates, review agencies and other relevant bodies to provide us with the necessary evidence to reach our conclusion on the risk.</p> <p>If such evidence is not available, we will instead need to consider what additional work we will be required to undertake to satisfy ourselves that we have reasonable evidence to support the conclusion that we will draw. Such work may include:</p> <ul style="list-style-type: none"> ■ Meeting with senior managers across the Authority; ■ Review of minutes and internal reports; ■ Examination of financial models for reasonableness, using our own experience and benchmarking data from within and outside the sector.
<p>Concluding on VFM arrangements</p>	<p>At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources.</p> <p>If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.</p>
<p>Reporting</p>	<p>We will report on the results of the VFM audit through our ISA 260 Report. This will summarise any specific matters arising, and the basis for our overall conclusion.</p> <p>If considered appropriate, we may produce a separate report on the VFM audit, either overall or for any specific reviews that we may undertake.</p> <p>The key output from the work will be the VFM conclusion (i.e. our opinion on the Authority's arrangements for securing VFM), which forms part of our audit report.</p>

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Whole of government accounts (WGA)

We are required to review your WGA consolidation and undertake the work specified under the approach that is agreed with HM Treasury and the National Audit Office. Deadlines for production of the pack and the specified approach for 2015/16 have not yet been confirmed.

Elector challenge

The Local Audit and Accountability Act 2014 gives electors certain rights. These are:

- The right to inspect the accounts;
- The right to ask the auditor questions about the accounts; and
- The right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on the elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised.

The costs incurred in responding to specific questions or objections raised by electors is not part of the fee. This work will be charged in accordance with the PSAA's fee scales.

Our audit team

Our audit team will be led by Andy Sayers and supported by Emma Larcombe and Jessica Hargreaves, and as we are a new audit team for the Authority we will bring a fresh perspective to the accounts. Appendix 2 provides more details on specific roles and contact details of the team.

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the Finance Team and the Governance, Audit, Risk Management and Standards Committee. Our communication outputs are included in Appendix 1.

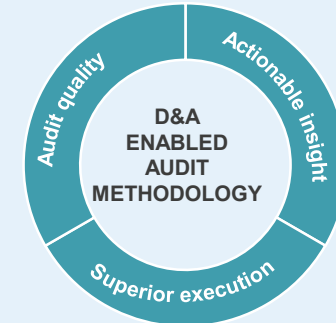
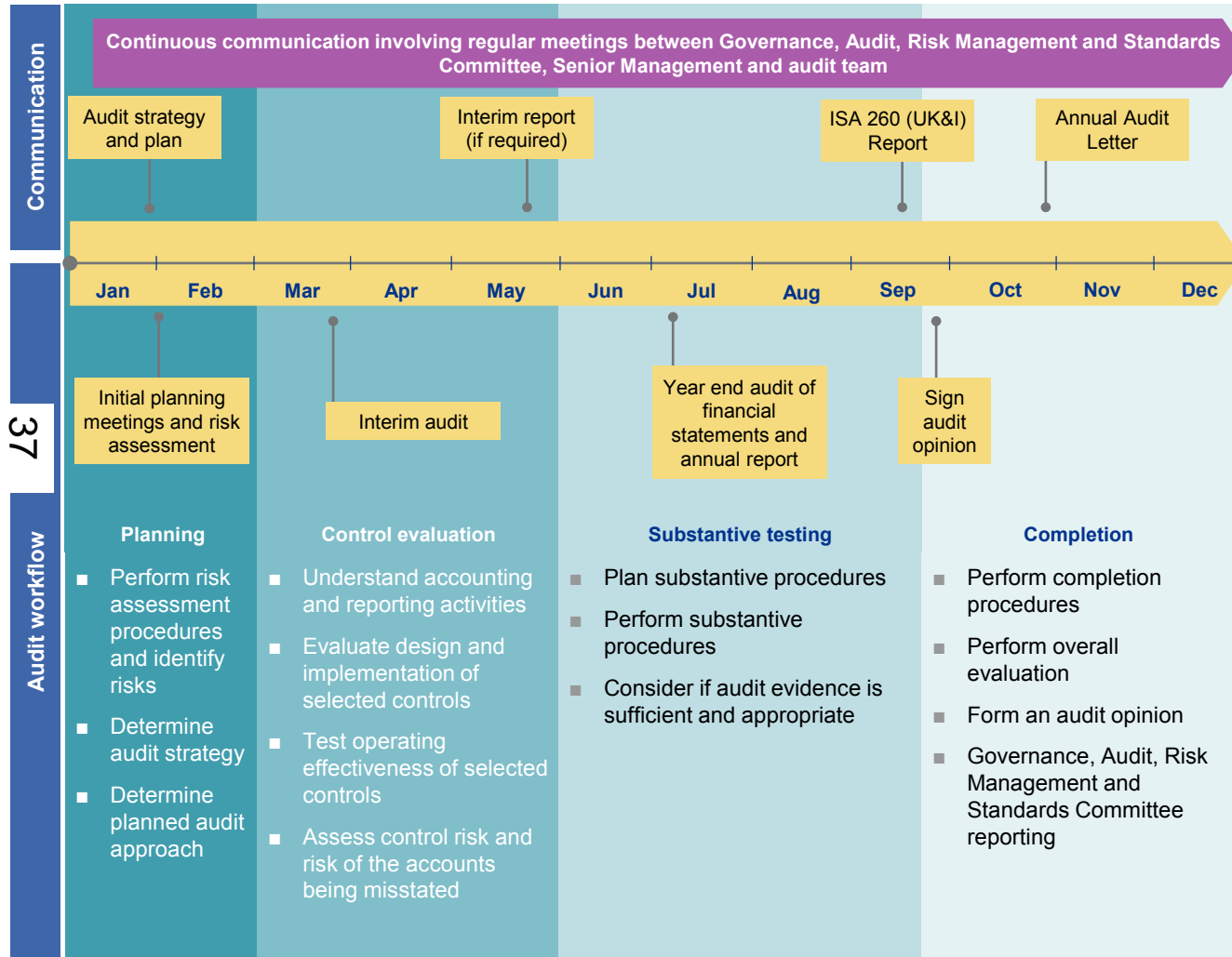
Independence and Objectivity

Auditors are also required to be independent and objective. Appendix 3 provides more details of our confirmation of independence and objectivity.

Audit fee

Our Audit Fee Letter 2015/2016 presented to you in April 2015 first set out our fees for the 2015/2016 audit. This letter also sets out our assumptions. We have not considered it necessary to make any changes to the agreed fees at this stage.

The planned audit fee for 2015/16 is £150,725 for the Authority. The planned audit fee for 2015/16 is £21,000 for the Pension Fund.



Driving more value from the audit through data and analytics

Technology is embedded throughout our audit approach to deliver a high quality audit opinion. Use of Data and Analytics (D&A) to analyse large populations of transactions in order to identify key areas for our audit focus is just one element. We strive to deliver new quality insight into your operations that enhances our and your preparedness and improves your collective 'business intelligence.' Data and Analytics allows us to:

- Obtain greater understanding of your processes, to automatically extract control configurations and to obtain higher levels assurance.
- Focus manual procedures on key areas of risk and on transactional exceptions.
- Identify data patterns and the root cause of issues to increase forward-looking insight.

We anticipate using data and analytics in our work around key areas such as accounts payable and journals. We also expect to provide insights from our analysis of these tranches of data in our reporting to add further value from our audit.



Your audit team has been drawn from our specialist public sector assurance department.



Name	Andy Sayers
Position	Partner
	<p>'My role is to lead our team and ensure the delivery of a high quality, value added external audit opinion.</p> <p>I will be the main point of contact for the Governance, Audit, Risk Management and Standards Committee and the Chief Executive,</p>

Andy Sayers
Partner
Tel: 07802 975 171



Name	Emma Larcombe
Position	Manager
	<p>'I provide quality assurance for the audit work and specifically any technical accounting and risk areas.</p> <p>I will work closely with Andy to ensure we add value.</p> <p>I will liaise with Dawn Calvert and other Executive Directors.'</p>

Emma Larcombe
Manager
Tel: 07920 257 310



Name	Jessica Hargreaves
Position	Assistant Manager
	<p>'I will be responsible for the on-site delivery of our work and will supervise the work of our audit assistants.'</p>

Jessica Hargreaves
Assistant Manager
Tel: 07468 740 813

Independence and objectivity

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The standards define 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Governance, Audit, Risk Management and Standards Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 Integrity, Objectivity and Independence requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Other than this auditors are required by the National Audit Office's Code of Audit Practice to:

- Carry out their work with integrity, independence and objectivity;
- Be transparent and report publicly as required;
- Be professional and proportional in conducting work;
- Be mindful of the activities of inspectorates to prevent duplication;
- Take a constructive and positive approach to their work;
- Comply with data security and other relevant requirements relating to the security, transfer, holding, disclosure and disposal of information.

PSAA's Terms of Appointment includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Auditors and senior members of their staff who are directly involved in the management, supervision or delivery of PSAA audit work should not take part in political activity.

- No member or employee of the firm should accept or hold an appointment as a member of an audited body whose auditor is, or is proposed to be, from the same firm. In addition, no member or employee of the firm should accept or hold such appointments at related bodies, such as those linked to the audited body through a strategic partnership.
- Audit staff are expected not to accept appointments as Governors at certain types of schools within the local authority.
- Auditors and their staff should not be employed in any capacity (whether paid or unpaid) by an audited body or other organisation providing services to an audited body whilst being employed by the firm.
- Auditors appointed by the PSAA should not accept engagements which involve commenting on the performance of other PSAA auditors on PSAA work without first consulting PSAA.
- Auditors are expected to comply with the Terms of Appointment policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the PSAA's written approval prior to changing any Engagement Lead in respect of each audited body.
- Certain other staff changes or appointments require positive action to be taken by Firms as set out in the Terms of Appointment.

Confirmation statement

We confirm that as of January 2016 in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Engagement Lead and audit team is not impaired.



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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment’s website (www.psa.co.uk).

External auditors do not act as a substitute for the audited body’s own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG’s work, in the first instance you should contact Andy Sayers the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG’s work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers, by email to Andrew.Sayers@kpmg.co.uk. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA’s complaints procedure by emailing generalenquiries@psaa.co.uk by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

REPORT FOR: Pension Fund Committee

Date of Meeting:

9 March 2016

Subject:

Information Report – Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

Responsible Officer:

Dawn Calvert, Director of Finance

Exempt:

No

Wards affected:

All

Enclosures:

Appendix 1 – Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009
Appendix 2 – Response to consultation

Section 1 – Summary

The report sets out the Department for Communities and Local Government (DCLG) consultation document entitled “Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009” and the Council’s response.

FOR INFORMATION

Section 2 – Report

1. In late November 2015 the Council, along with many other consultees “with an interest in the Local Government Pension Scheme,” received a consultation document from DCLG entitled “Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.” Comments were invited by 19 February 2016. A copy of the document is attached as Appendix 1.
2. The consultation document discusses many important issues in connection with the future management of the Local Government Pension Scheme including:
 - Deregulation of investment decisions
 - Investment Strategy Statement to replace Statement of Investment Principles
 - Non-financial factors – inappropriate use of investment policies
 - Investment – appropriate use of certain investments
 - Secretary of State’s intervention powers of intervention
3. However, the consultation process was limited to eight questions to which answers were requested divided into two proposals as follows:

Proposal 1: Adopting a local approach to investment

Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities’ investments are made prudently and having taken advice?

Are there any specific issues that should be reinstated? Please explain why.

Is six months the appropriate period for the transitional arrangements to remain in place?

Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?

Proposal 2: Introducing a safeguard – Secretary of State power of intervention

Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?

Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?

Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?

Do the proposals meet the objectives of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?

5. Members, advisers and officers were consulted on a response from the Council and the email attached as Appendix 2 was sent to DCLG by the closing date.

Financial Implications

6. Whilst significant changes in the Regulations can have a significant impact on the performance of the Fund there are no financial implications arising from this report.

Risk Management Implications

7. The risks arising from the management and investment of funds are included in the Pension Fund risk register.

Equalities implications

8. There are no direct equalities implications arising from this report.

Council Priorities

9. Investment performance has a direct impact on the financial health of the Pension Fund which directly affects the level of employer contribution which then, in turn, affects the resources available for the Council's priorities

Section 3 - Statutory Officer Clearance

Name Dawn Calvert Director of Finance

Date: 25 February 2016

Ward Councillors notified: NO

Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager
0208 424 1450

Background Papers - None



Department for
Communities and
Local Government

Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009

Consultation



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November 2015

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About this consultation

This consultation document and consultation process have been planned to adhere to the Consultation Principles issued by the Cabinet Office.

Representative groups are asked to give a summary of the people and organisations they represent, and where relevant who else they have consulted in reaching their conclusions when they respond.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department for Communities and Local Government will process your personal data in accordance with DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Individual responses will not be acknowledged unless specifically requested.

Your opinions are valuable to us. Thank you for taking the time to read this document and respond.

Are you satisfied that this consultation has followed the Consultation Principles? If not or you have any other observations about how we can improve the process please contact DCLG Consultation Co-ordinator.

Department for Communities and Local Government
2 Marsham Street
London
SW1P 4DF

or by e-mail to: consultationcoordinator@communities.gsi.gov.uk

The consultation process and how to respond

Scope of the consultation

<p>Topic of this consultation:</p>	<p>This consultation proposes to revoke and replace the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 with the draft regulations described in this paper. There are two main areas of reform:</p> <ol style="list-style-type: none"> 1. A package of reforms that propose to remove some of the existing prescribed means of securing a diversified investment strategy and instead place the onus on authorities to determine the balance of their investments and take account of risk. 2. The introduction of safeguards to ensure that the more flexible legislation proposed is used appropriately and that the guidance on pooling assets is adhered to. This includes a suggested power to allow the Secretary of State to intervene in the investment function of an administering authority when necessary.
<p>Scope of this consultation:</p>	<p>Views are sought on:</p> <ol style="list-style-type: none"> 1. Whether the proposed revisions to the investment regulations will give authorities the flexibility to determine a suitable investment strategy that appropriately takes account of risk. 2. Whether the proposals to introduce the power of intervention as a safeguard will enable the Secretary of State to intervene, when appropriate, to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.
<p>Geographical scope:</p>	<p>This consultation applies to England and Wales.</p>
<p>Impact Assessment:</p>	<p>The proposed interventions affect the investment of assets by local government pension scheme administering authorities. These authorities are all public sector organisations, so no impact assessment is required.</p>

Basic Information

To:	The consultation is aimed at all parties with an interest in the Local Government Pension Scheme (the Scheme) and in particular those listed on the Government's website: https://www.gov.uk/government/publications/local-government-pension-scheme-regulations-information-on-who-should-be-consulted
Body/bodies responsible for the consultation:	Secretary of State, Department for Communities and Local Government. The consultation will be administered by the Workforce, Pay and Pensions Division.
Duration:	25 November 2015 to 19 February 2016
Enquiries:	Enquires should be sent to Victoria Edwards. Please email LGPSReform@communities.gsi.gov.uk or call 0303 444 4057.
How to respond:	Responses to this consultation should be submitted to LGPSReform@communities.gsi.gov.uk by 19 February 2016 . Electronic responses are preferred. However, you can also write to: LGPS Reform Department for Communities and Local Government 2/SE Quarter, Fry Building 2 Marsham Street London SW1P 4DF
Additional ways to become involved:	If you would like to discuss the proposals, please email LGPSReform@communities.gsi.gov.uk
After the consultation:	All consultation responses will be reviewed and analysed. A Government response will then be published within three months, and subject to the outcome of this consultation, the resulting regulations laid in Parliament.
Compatibility with the Consultation Principles:	This consultation has been drafted in accordance with the Consultation Principles.

Background

Getting to this stage:	<p>The proposals in this consultation are the culmination of work looking into Local Government Pension Scheme investments that began in early 2013. It has been developed in response to the May 2014 consultation, <i>Opportunities for collaboration, cost savings and efficiencies</i>, which considered whether savings might be delivered through collective investment and greater use of passive fund management. A copy of the consultation and the Government's response is available on the Government's website: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies.</p> <p>The consultation responses called for a voluntary approach to reform, opposing the introduction of a single, national model of pooling. The Government has therefore invited authorities to develop their own proposals for pooling, subject to common criteria and guidance. The criteria for reform have been developed using the consultation responses and following a series of workshops and conversations with authorities and the fund management industry since the July Budget 2015.</p> <p>Some respondents to the May 2014 consultation also suggested that amendments were required to the investment regulations in order to facilitate greater investment in pooled vehicles. In addition, prior to that consultation, authorities and the fund management industry had called for wider reform. A small working group, whose participants are listed in Annex A, was established to look at whether the approach to risk management and diversification in the existing regulations was still appropriate. They recommended moving towards the "prudential person" approach that governs trust based pension schemes. The group also sought clarity as to whether certain types of investment were possible, such as the use of derivatives in risk management. The work of that group has informed the development of this consultation.</p> <p>In relaxing the regulatory framework for scheme investments, it is important to introduce safeguards to ensure that the less prescriptive approach is used appropriately. The July Budget 2015 announcement also indicated that measures should be introduced to ensure that those authorities who do not bring forward ambitious proposals for pooling, in keeping with the criteria, should be required to pool. This consultation therefore sets out how the Secretary of State might intervene to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.</p>
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<p>Previous engagement:</p>	<p>The proposed changes in this consultation are the result of a programme of engagement that began in summer 2013:</p> <ul style="list-style-type: none"> • Round table event, 16 May 2013. Representatives of administering authorities, employers, trade unions, the actuarial profession and academia discussed the potential for increased cooperation within the Scheme. • A call for evidence, run with the Local Government Association, June to September 2013. This gave anyone with an interest in the Scheme the opportunity to inform the Government's thinking on potential structural reform. The results were shared with the Shadow Scheme Advisory Board, which provided the Minister for Local Government with their analysis of the responses. • Consultation, <i>Opportunities for collaboration, cost savings and efficiencies</i>, May to June 2014. The consultation set out how savings of £470-660m a year could be achieved by collective investment and greater use of passive fund management. It also sought views as to how these reforms might best be implemented. The Government's response is available online: https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies. • Informal engagement, July to November, 2015. Since the July Budget 2015 announcement, officials have attended over 25 workshops and bi-lateral meetings with administering authorities and the fund management industry. These discussions have been used to develop the criteria for reform and inform how the proposed power of the Secretary of State to intervene might work. <p>In addition, the Investment Regulation Review Group was formed in 2012 to consider potential amendments to the investment regulations. The group included representatives from administering authorities, actuarial firms, pension lawyers and the fund management industry. An initial proposal for reform was prepared that has also informed the development of the draft regulations that are the subject of this consultation.</p>
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Introduction and Background

Introduction

1.1 In May 2014 the Government published a consultation which set out how savings of up to £660m a year might be achieved through greater use of passive management and pooled investment. Investing collectively can help authorities to drive down costs and access the benefits of scale, and also enables them to develop the capacity and capability to invest more cost effectively in illiquid asset classes such as infrastructure. The Government has therefore invited authorities to develop ambitious proposals for pooling assets that meet published criteria. More information about the criteria and process of reform is available on the Government's website:

<https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance>.

1.2 This consultation complements that invitation, recognising that the existing regulations place restrictions on certain investments that may constrain authorities considering how best to pool their assets. It therefore proposes to move to a prudential approach to securing a diversified investment strategy that appropriately takes account of risk. In so doing, and to ensure that authorities take advantage of the benefits of scale, the Government proposes to introduce a power to allow the Secretary of State to intervene to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.

1.3 This paper sets out the purpose and rationale of the suggested amendments to the investment regulations, and seeks views as to whether the proposed approach would best deliver those stated aims.

Background

1.4 With assets of £178bn at its last valuation on 31 March 2013, the Local Government Pension Scheme is one of the largest funded pension schemes in Europe. Several thousand employers participate in the Scheme, which has a total of 4.68 million active, deferred and pensioner members.¹ The Department for Communities and Local Government is responsible for the regulatory framework governing the Scheme in England and Wales.

1.5 The Scheme is managed through 90 administering authorities which broadly correspond to the county councils following the 1974 local government reorganisation as well as each of the 33 London boroughs. In most cases, the administering authorities are upper tier local authorities such as county or unitary councils, but there are also some authorities established specifically to manage their pension liabilities, for example the London Pension Fund Authority and the Environment Agency Pension Fund. The

¹ Scheme asset value and membership figures taken from Department for Communities and Local Government statistical data set - Local government pension scheme funds summary data: 2012 to 2013 <https://www.gov.uk/government/statistical-data-sets/local-government-pension-scheme-funds-summary-data-2012-to-2013>

administering authorities have individual governance and working arrangements. Each has its own funding level, cash-flow and balance of active, deferred and pensioner members. Authorities take these circumstances into account when preparing their investment strategies, which are normally agreed by the councillors on each authority's pension committee. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 set the legal framework for the development of these investment strategies and the investments carried out by administering authorities. This consultation proposes that the Government revokes and replaces those regulations.

1.6 Under the Public Service Pensions Act 2013, there is a requirement for a national scheme advisory board, as well as a local board for each of the 90 funds. In 2013, Scheme employers and the trade unions established a shadow board, which has been considering a number of issues connected with the Scheme, including its efficient management and administration. Appointments have now been made to the national scheme advisory board and the Chair is expected to be appointed shortly.

Getting to this stage

- 2.1 The consultation is formed of two main proposals:
1. A package of reforms that propose to remove some the existing prescribed means of securing a diversified investment strategy and instead place the onus on authorities to determine the balance of their investments and take account of risk. The changes proposed would move towards the “prudent person” approach to investment that applies to trust based pension schemes.
 2. The introduction of safeguards to ensure that the more flexible legislation proposed is used appropriately, and that the guidance on pooling assets is adhered to, including a power to allow the Secretary of State to intervene in the investment function of an administering authority when necessary.

Pooling assets to deliver the benefits of scale

2.2 The proposals set out in this consultation are the culmination of work carried out over the last two and a half years to explore how to reform the way the Scheme makes its investments in order to achieve the benefits of scale and drive efficiencies.

2.3 In summer 2013, the coalition government launched a call for evidence to explore how the Scheme might be made more sustainable and affordable in the long term. 133 responses were received, many of which took the opportunity to discuss whether collective investment and greater collaboration might deliver savings for the Scheme.

2.4 Following the call for evidence, the Minister for the Cabinet Office and Minister for Local Government commissioned a cost-benefits analysis from Hymans Robertson on a range of proposals. Hymans Robertson’s report explored three areas:

- **The cost of investment:** Many of the costs associated with investment are not transparent and so difficult to capture. The costs of managing and administering the Scheme were reported as being £536 million in 2012-13.² However, Hymans Robertson found that the actual cost was likely to be rather higher; with investment costs alone estimated as in excess of £790 million a year.³
- **Approaches to collaboration:** Hymans Robertson was asked to examine the costs and benefits of three options for reform: merging the authorities into 5-10 funds, creating 5-10 collective investment vehicles, or establishing just 1-2 collective investment vehicles. They found that the net present value of savings over ten years was highest with a small number of vehicles, while merging funds offered the lowest benefit.⁴

² Local government pension scheme funds summary data: 2012 to 2013

³ Department for Communities and Local Government: Local Government Pension Scheme structure analysis, Hymans Robertson pp. 10-11. <https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies>

⁴ Hymans Robertson, p.6

- **The aggregate performance of the scheme:** The report found that the Scheme as a whole had been achieving the market rate of return in each of the main equity markets over the ten years to March 2013. If the Scheme's investments in bonds and equities had been managed passively instead of actively, authorities could have saved at least £230m a year in management fees without affecting overall investment returns.⁵

2.5 Drawing on the Hymans Robertson report and the call for evidence, the coalition government published a consultation in May 2014 entitled *Opportunities for collaboration, cost savings and efficiencies*. This set out how the Scheme could save up to £660m a year by using collective investment vehicles and making greater use of passive management for listed assets like bonds and equities. The consultation sought views on these proposals, and how they might be most effectively implemented. Respondents were broadly in favour of pooling assets, but felt that any reform should be voluntary and led by administering authorities. While many recognised a role for passive management in an investment strategy, most also felt that some active management should be retained.

2.6 At the July Budget 2015, Ministers having reflected on the consultation responses, the Chancellor announced the Government's intention to invite administering authorities to bring forward proposals for pooling local government pension scheme investments. Authorities' proposals would be assessed against published criteria, designed to encourage ambition in the pursuit of efficiencies and the benefits of scale. These criteria have now been published and are available online at <https://www.gov.uk/government/publications/local-government-pension-scheme-investment-reform-criteria-and-guidance>.

Updating the investment regulations

2.7 When considering the implications of creating asset pools amongst authorities, some respondents to the May 2014 consultation took the opportunity to call for a review of the existing investment regulations. At their introduction in 2009, the regulations sought to ensure that authorities established a balanced and diversified portfolio by placing restrictions on the proportion of their assets that could be invested in different vehicles. For example, deposits with a single bank, institution or person, (other than the National Savings Bank), were restricted to 10% of an authority's assets. These restrictions have been kept under regular review and have been subject to change following representations from the investment sector and pension fund authorities.

2.8 Some respondents to the consultation suggested that the current limits on investments would prevent authorities from making meaningful allocations to a collective investment vehicle, one of the leading options for asset pooling, as the allocation to particular types of vehicle is capped at 35%. Participants in the London Boroughs' collective investment vehicle and the collaboration between the London Pension Fund Authority and Lancashire County Council also wrote to the Department encouraging reform in this area.

⁵ Hymans Robertson, p.12

2.9 While the proposals for collective investment in the May 2014 consultation prompted encouragement to review the investment regulations, the idea of reform was not new. In 2012, following representations from the investment sector, the Government formed a small working group to revisit and examine the investment regulations with input from actuaries, fund managers and administering authorities. This group, whose membership is set out in Annex A, recommended that a more permissive approach should be taken to the legislative framework, similar to the “prudent person” model that applies to trust based pension schemes. This approach places the onus on the pension fund to determine a suitable balance of investments to meet its liabilities, which are clearly articulated in an investment strategy. The group also felt that the existing regulations introduced uncertainty for some authorities as to what constituted a permitted investment, as some asset classes were explicitly referenced but others were not. In particular, concern has been expressed as to whether or not pension fund authorities are permitted to invest in vehicles such as derivatives, hedge funds and forward currency contracts.

2.10 The proposals in this consultation paper therefore seek to address these issues, placing the onus on authorities to determine a diversified investment strategy that appropriately takes risk into account.

2.11 However, in relaxing the regulatory framework for scheme investments, it is also important to introduce safeguards to ensure that the less prescriptive approach proposed is used appropriately. Similarly, the July Budget 2015 announcement stated that draft regulations would be introduced to require an authority to pool its investments if it did not bring forward ambitious proposals that met the Government’s criteria. This consultation therefore sets out how the Secretary of State might intervene to ensure that authorities take advantage of the benefits of scale offered by pooling and deliver investment strategies that adhere to regulation and guidance.

Response to the Law Commission’s Review of Fiduciary Duty

2.12 The Kay Review on Fiduciary Duty published its final report in July 2012. In addition to making a number of recommendations to address the excessive focus on short-term performance in equity investment markets, it recommended that the Government ask the Law Commission to review the fiduciary duties of investment intermediaries amid concerns that these common law duties were being interpreted by some pension schemes as a requirement to focus solely on short-term financial returns.

2.13 In their report, published in July 2014, the Law Commission called on the Department to review:

- Whether the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 should transpose article 18(1) of the Institutions for Occupational Retirement Provision (IORP) Directive, and
- Those aspects of Regulation 9 of the 2009 Regulations which require investment managers to be appointed on a short-term basis and reviewed every three months.

2.14 These recommendations were supported by the Government's progress report on the implementation of the Kay Review published in October 2014 by the Department for Business Innovation and Skills.

2.15 Article 18(1) of the IORP Directive requires assets to be invested in the best interests of members and beneficiaries and, in the event of a conflict of interest, in the sole interests of members and beneficiaries.

2.16 Regulation 4 of The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005 No 3378) transposed Article 18(1):

"4. (1) The trustees of a trust scheme must exercise their powers of investment, and any fund manager to whom any discretion has been delegated under section 34 of the 1995 Act (power of investment and delegation) must exercise the discretion, in accordance with the following provisions of this regulation

(2) The assets must be invested:

- (a) In the best interests of members and beneficiaries; and
- (b) In the case of a potential conflict of interest, in the sole interest of members and beneficiaries."

2.17 The Local Government Pension Scheme is a statutory scheme made under section 1 of the Public Service Pensions Act 2013 and previously under The Superannuation Act 1972. It is not subject to trust law and those responsible for making investment decisions in the Scheme are not therefore required to comply with Regulation 4 of the 2005 Regulations.

2.18 However, this does nothing to change the general legal principles governing the administration of Scheme investments and how those responsible for such decisions should exercise their duties and powers under the Scheme's investment regulations.

2.19 In a circular issued by the then Department of the Environment in 1983 (No 24), the Secretary of State took the view that administering authorities should pay due regard to the principle contained in the case of *Roberts v Hopwood* [1925] A.C. 578 p. 595:

"A body charged with the administration for definite purposes of funds contributed in whole or in part by persons other than members of that body owes, in my view, a duty to those latter persons to conduct that administration in a fairly business-like manner with reasonable care, skill and caution, and with a due and alert regard to the interest of those contributors who are not members of the body. Towards these latter persons, the body stands somewhat in the position of trustees or managers of the property of others."

2.20 Those in local government responsible for making investment decisions must also act in accordance with ordinary public law principles, in particular, the ordinary public law principles of reasonableness. They risk challenge if a decision they make is so unreasonable that no reasonable person acting reasonably could have made it.

2.21 Having considered fully the recommendation made by the Kay Review and supported by both the Law Commission and the Government, Ministers are satisfied that the Scheme is consistent with the national legislative framework governing the duties placed on those responsible for making investment decisions. The position at common law

is also indistinguishable from that produced by the 2005 Regulations applicable in respect of trust-based schemes.

2.22 We do, however, propose to remove the requirement for the performance of investment managers to be reviewed once every three months from the regulations.

Proposal 1: Adopting a local approach to investment

Deregulating and adopting a local approach to investment

3.1 In developing these draft regulations, the Government has sought, where appropriate, to deregulate and simplify the regulations that have governed the management and investment of funds since 2009. Some of the existing provisions have not been carried forward into the draft 2016 Regulations in the expectation that they would be effectively maintained by general law provisions and so specific regulation is no longer needed. For example, those making investment decisions are still required to act prudently, and there remains a statutory requirement to take and act on proper advice. Some of the provisions in the 2009 Regulations which have not been carried forward on this basis include:

- Stock lending arrangements under Regulation 3(8) and (9) of the 2009 regulations. The view is taken that the definition of “investment” in draft Regulation 3 is sufficient given that a stock lending arrangement can only be used if it falls within the ordinary meaning of an “investment”.
- Regulation 8(5) of the 2009 regulations ensures that funds are managed by an adequate number of investment managers and that, where there is more than one investment manager, the value of the fund money managed by them is not disproportionate. Here, the view is taken that administering authorities should be responsible for managing their own affairs and making decisions of this kind based on prudent and proper advice.
- There are many provisions in the 2009 Regulations which impose conditions on the choice and terms of appointments of investment managers. Since the activities of investment managers are governed by the contracts under which they are appointed, the view is taken that making similar provision in the 2016 Regulations would be unnecessary duplication. Examples include the requirement for investment managers to comply with an administering authority’s instructions and the power to terminate the appointment by not more than one month’s notice.
- Regulation 12(3) of the 2009 Regulations requires administering authorities to state the extent to which they comply with guidance given by the Secretary of State on the Myners principles for investment decision making. As part of the wider deregulation, the draft regulations make no provision to report against these principles, although authorities should still have regard to the guidance.

3.2 These examples of deregulation are for illustrative purposes only. It is not an exhaustive list of provisions which the Government proposes to remove. Consultees are asked to look carefully at the full extent of deregulation and comment on any particular case that raises concerns about the impact such an omission might have on the effective management and investment of funds.

Investment strategy statement

3.3 As part of this deregulation, the draft regulations also propose to remove the existing schedule of limitations on investments. Instead authorities will be expected to take a prudential approach, demonstrating that they have given consideration to the suitability of different types of investment, have ensured an appropriately diverse portfolio of assets and have ensured an appropriate approach to managing risk.

3.4 Key to this will be the investment strategy statement, which authorities will be required to prepare, having taken proper advice, and publish. The statement must cover:

- A requirement to use a wide variety of investments.
- The authority's assessment of the suitability of particular investments and types of investments.
- The authority's approach to risk, including how it will be measured and managed.
- The authority's approach to collaborative investment, including the use of collective investment vehicles and shared services.
- The authority's environmental, social and corporate governance policy.
- The authority's policy on the exercise of rights, including voting rights, attached to its investments.

Transitional arrangements

3.5 Draft regulation seven proposes to require authorities to publish an investment strategy statement no later than six months after the regulations come into force (this is currently drafted as 1 October 2016, in case the draft regulations come into effect on 1 April 2016). However, the draft regulations would also revoke the existing 2009 Regulations when they come into effect. Transitional arrangements are therefore required to ensure that an authority's investments and investment strategy are regulated between the draft regulations coming into effect and the publication of an authority's new investment strategy statement. The transitional arrangements proposed in draft regulation 12 would mean that the following regulations in the 2009 Regulations would remain in place until the authority publishes an investment strategy or six months lapses from the date that the regulations come into effect:

- 11 (investment policy and investment of pension fund money)
- 14 (restrictions on investments)
- 15 (requirements for increased limits)
- Schedule 1 (table of limits on investments)

Statement of Investment Principles

3.6 We do not propose to carry forward the existing requirement under regulation 12 of the 2009 Regulations to maintain a Statement of Investment Principles. However, the main elements, such as risk, diversification, corporate governance and suitability, will instead be carried forward as part of the reporting requirements of the new investment strategy

statement. Administering authorities will still be required to maintain their funding strategy statements under Regulation 58 of the 2013 regulations.

Non-financial factors

3.7 The Secretary of State has made clear that using pensions and procurement policies to pursue boycotts, divestments and sanctions against foreign nations and the UK defence industry are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government. The Secretary of State has said, “Divisive policies undermine good community relations, and harm the economic security of families by pushing up council tax. We need to challenge and prevent the politics of division.”

3.8 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 already require administering authorities to publish and follow a statement of investment principles, which must comply with guidance issued by the Secretary of State. The draft replacement Regulations include provision for administering authorities to publish their policies on the extent to which environmental, social and corporate governance matters are taken into account in the selection, retention and realisation of investments. Guidance on how these policies should reflect foreign policy and related issues will be published ahead of the new Regulations coming into force. This will make clear to authorities that in formulating these policies their predominant concern should be the pursuit of a financial return on their investments, including over the longer term, and that, reflecting the position set out in the paragraph above, they should not pursue policies which run contrary to UK foreign policy.

Investment

3.9 A few definitions and some aspects of regulation 3, which describes what constitutes an investment for the purpose of these regulations, have been updated to take account of changing terminology and technical changes since the regulations were last issued in 2009. For example, the reference to the London International Financial Futures Exchange (LIFFE) has been removed as it now operates as a clearing house and so is covered by the approved stock exchange definition.

3.10 Some additional information has been included to make clear that certain investments, such as derivatives, may be used where appropriate. The Government expects that having considered the appropriateness of an investment in their investment strategy statement, authorities would only use derivatives as a means of managing risk, and so has not explicitly stated that this should be the case.

Questions

1. Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?
2. Are there any specific issues that should be reinstated? Please explain why.

3. Is six months the appropriate period for the transitional arrangements to remain in place?
4. Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?

Proposal 2: Introducing a safeguard - Secretary of State power of intervention

Summary of the proposal

4.1 The first part of this consultation lifts some of the existing restrictions on administering authorities' investments in order to make it easier for them to pool their investments and access the benefits of scale. To ensure that this new flexibility is used appropriately, the consultation also proposes to introduce a power to intervene in the investment function of an administering authority if the Secretary of State believes that it has not had regard to guidance and regulations. The consultation sets out the evidence that the Secretary of State may draw on before deciding to intervene, and makes clear that any direction will need to be proportionate. The power proposed in this consultation is intended to allow the Secretary of State to act if best practice or regulation is being ignored, which will help to ensure that authorities continue to pursue more efficient means of investment.

4.2 The July Budget 2015 announcement set out the Government's intention to introduce "backstop" legislation to require those authorities who do not bring forward sufficiently ambitious plans to pool their investments. It also explained that authorities' proposals would need to meet common criteria, which have been published with draft guidance alongside this consultation. The draft power to intervene discussed in this paper could be used to address authorities that do not bring forward proposals for pooling their assets in line with the published criteria and guidance. The guidance will be kept under review, and will be revised as circumstances change and authorities' asset pools evolve.

4.3 The following sections set out the process for intervention described in draft regulation 8.

Determining to intervene

4.4 The draft regulations propose to give the Secretary of State the power to intervene in the investment function an administering authority, if the Secretary of State has determined that the administering authority has failed to have regard to the regulations governing their investments or guidance issued under draft regulation 7(1). In reaching that conclusion, the Secretary of State will consider the available evidence, which might include:

- Evidence that an administering authority is ignoring information on best practice, for example, by not responding to advice provided by the scheme advisory board to local pension boards.
- Evidence that an administering authority is not following the investment regulations or has not had regard to guidance published by the Secretary of State under draft Regulation 7 (1). For example, this might include failing to participate in one of the large asset pools described in the existing draft guidance, or proposing a pooling arrangement that does not adhere to the criteria and guidance.

- Evidence that an administering authority is carrying out another pension-related function poorly, such as an unsatisfactory report under section 13(4) of the Public Service Pensions Act 2013, or another periodic reporting mechanism. (Section 13(4) of the 2013 Act requires a person appointed by the Secretary of State to report on whether the actuarial valuation of a fund has been carried out in accordance with Scheme regulations, in a way that is consistent with other authorities' valuations, and so that employer contribution rates are set to ensure the solvency and long term cost efficiency of the fund.)

4.5 If the Secretary of State has some indication to suggest that intervention might be necessary, the draft regulations propose that he may order a further investigation to provide him with the analysis required to make a decision. If additional evidence is sought, draft regulation 8(5) would allow the Secretary of State to carry out such inquiries as he considers appropriate, including seeking advice from external experts if needed. In this circumstance, the administering authority would be obliged to provide any data that was deemed necessary to determine whether intervention is required. The authority would also be invited to participate in the review and would have the opportunity to present evidence in support of its existing or proposed investment strategy.

The process of intervention

4.6 If the Secretary of State is satisfied that an intervention is required, he would then need to determine the appropriate extent of intervention in the authority's investment function. The draft regulations propose to allow the Secretary of State to draw on external advice to determine what the specific intervention should be if necessary.

4.7 Draft regulation 8(2) describes the interventions that the Secretary of State may make. The power has been left intentionally broad to ensure that a tailored and measured course of action is applied, based on the circumstances of each case. For example, in some cases it may be appropriate to apply the intervention just to certain parts of an investment strategy, whereas in particularly concerning cases, more substantial action might be required. The proposed intervention might include, but is not limited to:

- Requiring an administering authority to develop a new investment strategy statement that follows guidance published under draft Regulation 7(1).
- Directing an administering authority to invest all or a portion of its assets in a particular way that more closely adheres to the criteria and guidance, for instance through a pooled vehicle.
- Requiring that the investment functions of the administering authority are exercised by the Secretary of State or his nominee.
- Directing the implementation of the investment strategy of the administering authority to be undertaken by another body.

4.8 The Secretary of State will write to the authority outlining the proposed intervention. As a minimum, this proposal will include:

- A detailed explanation of why the Secretary of State is intervening and the evidence used to arrive at their determination.

- A clear description of the proposed intervention and how it will be implemented and monitored.
- The timetable for the intervention, including the period of time until the intervention is formally reviewed.
- The circumstances under which the intervention might be lifted prior to review.

4.9 The authority will then be given time to consider the proposal and present its argument for any changes that it thinks should be made. If, at the end of that period an intervention is issued, any resulting costs, charges and expenses incurred in administering the fund would be met by the pension fund assets.

Review

4.10 As set out above, each intervention will be subject to a formal review period which will be set by the Secretary of State but may coincide with other cyclical events such as the preparation of an annual report or a triennial valuation. At the end of that period, progress will be assessed and the Secretary of State will decide whether to end, modify or maintain the current terms of the intervention, and will notify the authority of the outcome. The authority will also have the opportunity to make representations to the Secretary of State if it feels a different course of action should be followed. Throughout this period of intervention, the authority will be supported to improve its investment function, so that it is well placed to bring the intervention to an end at the first opportunity.

4.11 The Secretary of State's direction will include details about what is required of the authority in order to end the intervention, and how progress will be measured. Progress could, for example, be measured by creating a set of performance indicators to be monitored on an ongoing basis by Government officials, the local pension board, the scheme advisory board, or an independent body. A regime of regular formal reports to the Secretary of State could also be required.

4.12 The draft regulations also allow the Secretary of State to determine that sufficient improvement has been made to end the intervention before the review date. The administering authority may also make representations to the Secretary of State before that date, if it has clear evidence that the prescribed action is no longer appropriate.

Questions

5. Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?
6. Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?
7. Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?

8. Do the proposals meet the objectives of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?

Summary of the draft regulations

(1) Citation, commencement and extent

This details the citation and scope of the draft regulations, and gives the date at which they will come into force.

(2) Interpretation

These provisions define terms used in the draft regulations with reference to legislation, and cite the legislation that gives administering authorities the powers that may be impacted by the draft regulations.

(3) Investment

This draft regulation defines what is considered an investment for the purposes of the regulations. This definition includes futures, options, derivatives, limited partnerships and some types of insurance contracts. It also defines who a person with whom a contract of insurance can be entered into is.

(4) Management of a pension fund

This draft regulation lists the monies that an administering authority must credit to its pension fund, including employer and employee contributions, interest, and investment capital and income. It also sets out the administering authority's responsibility to pay benefits entitled to members, and states that, except where prohibited by other regulations, costs of administering the fund can be paid by the fund.

(5) Restriction on power to borrow

This proposed regulation outlines the limited circumstances under which an administering authority can borrow money that the pension fund is liable to repay.

(6) Separate bank account

The draft regulation states that an administering authority must deposit all pension fund monies in a separate account, and lists those institutions that can act as a deposit taker. It also states that the deposit taker cannot use pension fund account to set-off any other account held by the administering authority or a connected party.

(7) Investment strategy statement

This draft regulation places an obligation on the administering authority to consult on and publish an investment strategy statement, which must be in accordance with guidance from the Secretary of State. The statement should demonstrate that investments will be suitably diversified, and it should outline the administering authority's maximum allocations for different asset classes, as well as their approach to risk and responsible investing.

In many respects, the investment strategy statement replaces the list of restrictions given in Schedule 1 of the 2009 Regulations and enables the criteria to be determined at local

level. Schedule 1 of the 2009 Regulations will remain in force until such time that the new investment strategy statements have to be published.

Provision is made for authorities to publish their policy on the extent to which environmental, social and corporate governance factors are taken into account in the selection, retention and realisation of investments.

Separate guidance will be issued by the Secretary of State that will clarify how the Government's recent announcement on boycotts, sanctions and disinvestment will be exercised.

(8) Directions by the Secretary of State

This provision would grant the Secretary of State the power to intervene in the investment function of an administering authority if he is satisfied that the authority is failing to have regard to regulation and guidance. He can also initiate inquiries to determine if an intervention is warranted, and must consult with the authority concerned. Once it is determined that an intervention is needed, the Secretary of State can intervene by directing the authority undertake a broad range of actions to remedy the situation.

(9) Investment managers

This draft regulation details how an administering authority must appoint external investment managers.

(10) Investments under section 11(1) of the Trustee Investments Act 1961

This draft regulation allows administering authorities to invest in Treasury-approved collective investment schemes.

(11) Consequential amendments

This proposed regulation lists the prior regulations that are amended by the draft amendments.

(12) Revocations and transitional provisions

The draft provision lists the regulations that would be revoked if the draft regulations come into effect. It also proposes transitional arrangements to ensure that the existing regulations governing the investment strategy remain in place until a new investment strategy statement is published by an authority under draft regulation seven. These transitional arrangements would apply for up to six months after the draft regulations came into effect.

Annex A: Members of the Investment Regulation Review Group

Alison Hamilton	Barnet Waddingham
Bob Claxton	Wandsworth Pension Fund
Clifford Sims	Squire Patton Boggs
Dawn Turner	Environment Agency Pension Fund
Geoff Reader	Bedford Pension Fund
Graeme Russell	Greater Gwent Pension Fund
Guy Sears	Investment UK
Loretta Stowers	Greater Manchester Pension Fund
Nick Buckland	Dorset Pension Fund
Nigel Keogh	Chartered Institute of Public Finance and Accountancy
Paul Dale	Bromley Borough Council
Peter Morris	Greater Manchester Pension Fund

Dear Sirs

I refer to the consultation document issued in November 2015.

My comments on the questions on behalf of the London Borough of Harrow Pension Fund are as follows:

- 1. Does the proposed deregulation achieve the intended policy aim of removing any unnecessary regulation while still ensuring that authorities' investments are made prudently and having taken advice?**

We believe that the proposed deregulation does broadly achieve the intended policy of removing unnecessary regulation but DCLG should consider whether they can provide further clarity on "proper advice."

- 2. Are there any specific issues that should be reinstated? Please explain why.**

No

- 3. Is six months the appropriate period for the transitional arrangements to remain in place?**

We would prefer a twelve months' period since it would allow us to benefit from the triennial valuation when producing our first Investment Strategy Statement.

- 4. Should the regulation be explicit that derivatives should only be used as a risk management tool? Are there any other circumstances in which the use of derivatives would be appropriate?**

We do not believe that such regulation would be appropriate since, for example, it could impede efficient portfolio management and would cause problems with liability driven investments.

We also feel that the regulations should specify that derivatives and other complex financial products should only be used where pension committee members have received appropriate technical training to be able to understand the derivative product and have taken independent expert advice.

5. Are there any other sources of evidence that the Secretary of State might draw on to establish whether an intervention is required?

The draft regulations are very widely drawn and would probably be sufficient. However, if DCLG wish to give examples of sources of evidence something along the following lines might be helpful:

- *Adverse auditor's report*
- *Adverse report from Pensions Regulator*
- *Adverse report by actuary*
- *Adverse reports from Pensions Ombudsman or exceptionally high number of cases where the fund has failed to provide a proper service*
- *Critical report from local Pension Board*
- *Evidence that the pension committee members and supporting officers and advisors do not have the relevant skills and knowledge*
- *Substantially poorer returns relative to other funds over a rolling three years period*
- *Employer contributions substantial higher than other funds without good reason*
- *Proven complaints from whistle blowers*

6. Does the intervention allow authorities sufficient scope and time to present evidence in favour of their existing arrangements when either determining an intervention in the first place, or reviewing whether one should remain in place?

Since no timetable is given this question is difficult to answer. However, Harrow would comply with any reasonable requirements.

7. 7. Does the proposed approach allow the Secretary of State sufficient flexibility to ensure that he is able to introduce a proportionate intervention?

This is for the Secretary of State to decide but he should consider the role that expert and independent support could play in determining what a proportionate intervention might be.

8. Do the proposals meet the objectives of the policy, which are to allow the Secretary of State to make a proportionate intervention in the investment function of an administering authority if it has not had regard to best practice, guidance or regulation?

This is for the Secretary of State to decide.

Whilst it is not specifically part of this consultation we are concerned as to any movement to impose a particular investment strategy, specifically infrastructure, onto LGPS funds. We would comment as follows:

- Infrastructure investments are very varied in nature and therefore having to target a certain percentage of the fund on them is quite inappropriate. For example, sizeable exposure to **equity** infrastructure would be unsuitable for a pension fund.
- Being forced into infrastructure regardless of the price / valuation of the investment cannot be appropriate

Regards

Ian

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REPORT FOR: Pension Fund Committee

Date of Meeting:	9 March 2016
Subject:	Information Report – Pooling Criteria and Guidance and London Pensions Collective Investment Vehicle
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	Appendix 1 – Local Government Pension Scheme: Investment Reform Criteria and Guidance Appendix 2 – London CIV response to criteria and guidance Appendix 3 – LB Harrow response to criteria and guidance Appendix 4 – CIV Chief Executive Progress Report

Section 1 – Summary

The report sets out the current position as regards the development of Local Government Pension Scheme pooling arrangements and asks Members to consider setting up a small group to assist officers in the development of proposals over the next three months.

FOR INFORMATION

Section 2 – Report

1. At their meeting on 25 November 2015 the Committee received a report which summarised the progress made in setting up the London Local Government Pension Scheme Collective Investment Vehicle (CIV) and the Harrow Fund's involvement therein. In attendance at the meeting was Mr Hugh Grover, Chief Executive of the CIV who answered Members questions in relation to the progress to date and the future plans for the CIV.
2. In late November 2015 the Council, along with all other administering authorities of the Local Government Pension Scheme, received a document from the Department for Communities and Local Government (DCLG) entitled "Local Government Pension Scheme: Investment Reform Criteria and Guidance." A copy of the document is attached as Appendix 1 and the requirements summarised below. DCLG required a response to this document by 19 February 2016.

Local Government Pension Scheme: Investment Reform Criteria and Guidance

Each administering authority was required to address the following issues:

Paragraph 1.1 – *Authorities are now invited to submit proposals for pooling which the Government will assess against the criteria in this document*
Paragraph 2.1 - *Submissions should include a commitment to pooling and a description of their progress towards formalising their arrangements with other authorities"*

The Guidance stated that the criteria against which compliance would be measured were as follows:

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

Paragraph 2.1 stated that *Authorities can choose whether to make individual or joint submissions or both.*

Members, advisers and officers have considered the options and have chosen, along with all the other members of the CIV, to be associated with the CIV response (Appendix 2) but to provide a covering note making the pooling commitment as required in the Guidance (Appendix 3).

In addition to these requirements, in Paragraph 2.2 DCLG state as follows:

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

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

These requirements are discussed further in paragraphs 4, 5 and 6 below.

3. Since the Committee last met, the Pensions CIV Sectoral Joint Committee, on which all the 31 London borough participants sit, has met once, on 10 February 2016. Appendix 4 is the Progress Update Report presented by the Chief Executive to that meeting. The CIV was formally launched in the House of Lords on 12 February and, on 25 February the first seminar for officers was held.
4. Each administering authority and its “pool” provider must now address various issues in time for a submission by 15 July. Specifically, the submission must include:
 - A fully transparent assessment of investment costs and fees as at 31 March 2013.
 - A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
 - A detailed estimate of savings over the next 15 years.
 - A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
 - A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.
5. Over the next few months many other issues also need to be taken into account, largely relating to the speed and efficiency of transition including:
 - Ministers apparently wish to see progress leading to all listed assets being within pools by 2020
 - Assets to remain outside pooling arrangements to be identified
 - Whilst administering authorities are some way from being instructed to terminate their mandates with existing managers Ministers may have little sympathy with Fund's trying to avoid pooling by unreasonably seeking to retain arrangements with existing managers.

- Managers, including “boutique” managers who had previously shown little interest in joining pooling arrangements are now showing more interest.
 - There are currently no immediate proposals within the CIV work programme to include any of the Harrow managers/mandates
6. A report covering all relevant issues will be presented to the Committee at its next meeting. However, officers would appreciate some earlier input from Members and advisers and the Committee is asked to consider whether a small working group could be set up to assist.

Financial Implications

7. Whilst the pooling initiatives will have a significant impact on the performance of the Fund there are no financial implications arising from this report.

Risk Management Implications

8. The risks arising from the management and investment of funds are included in the Pension Fund risk register.

Equalities implications

9. There are no direct equalities implications arising from this report.

Council Priorities

9. Investment performance has a direct impact on the financial health of the Pension Fund which directly affects the level of employer contribution which then, in turn, affects the resources available for the Council’s priorities.

Section 3 - Statutory Officer Clearance

Name	Dawn Calvert	<input checked="" type="checkbox"/>	Director of Finance
Date:	25 February 2016		

Ward Councillors notified:	NO
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Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager
0208 424 1450

Background Papers - None

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Department for
Communities and
Local Government

Local Government Pension Scheme: Investment Reform Criteria and Guidance



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Ministerial Foreword

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

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

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

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

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

Marcus Jones

Criteria

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

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

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

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

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

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

- i. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
- ii. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

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

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

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

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

As part of their proposals, authorities should provide:

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

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

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

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

Addressing the criteria

Requirements and Timetable

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

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

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

Assessing the proposals against criteria

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

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

Transitional arrangements

2.5 Plans should be made to transfer assets to the pools as soon as practicable. Analysis commissioned by the Government from PricewaterhouseCoopers (PwC) indicates that, even those pooling mechanisms requiring supporting infrastructure, such as collective investment vehicles, could be established within 18 months. It is expected that liquid assets are transferred into the pools over a relatively short timeframe, beginning from April 2018. It is recognised that illiquid assets are likely to transition over a longer period of time. For the avoidance of doubt, investments with high penalty costs for early

exit should not be wound up early on account of the pooling arrangements, but should be transferred across as soon as practicable, taking into account value for money considerations. Any assets that are held outside of the pool should be kept under review to ensure that arrangement continues to provide value for money.

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

Support to develop proposals

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

Legislative context

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

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

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

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

Supporting guidance

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

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

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

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

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

The case for collective investment

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

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

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

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

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

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

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

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

Achieving appropriate scale

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

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

² Dyck and Pomorski, *Is bigger better? Size and Performance in Pension Plan Management*, pp.14-15

³ Hymans Robertson report, pp.14-15

⁴ Sir Merrick Cockell, writing in the *Pensions Expert* on 30 September 2015

⁵ Government Response to the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Recommendation 1.6,

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

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

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

Investment in infrastructure and other illiquid or alternative assets

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

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

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

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

⁶ Hymans Robertson report, p.24

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

Investments outside of the pools

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

Property

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

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

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

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

Addressing the criterion

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

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

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

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

B. Strong governance and decision making

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

- i. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
- ii. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.

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

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

Maintaining democratic accountability

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

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

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

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

Strategic asset allocation

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

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

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

Effective and timely decision making

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

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

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

3.31 A number of authorities have already delegated hiring and dismissing managers to a sub-committee comprised predominantly of officers. This has allowed these authorities to

react more quickly to changes in the market, taking advantage of opportunities as they arise. Similarly, delegating implementation decisions to the pool will allow the participating authorities to benefit not only from more streamlined decision making, but also from effecting those decisions at scale.

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

Responsible investment and effective stewardship

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

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

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

Enacting an environmental, social and corporate governance policy

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

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

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

⁹ The Kay Review, p.12

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

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

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

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

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

Addressing the criterion

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

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

- How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.
- The extent to which benchmarking is used by the authority to assess their own governance and performance and that of the pool(s), for example by undertaking the Scheme Advisory Board's key performance indicator assessment.

C. Reduced costs and excellent value for money

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

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

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

Scope for savings

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

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

¹⁰ Hymans Robertson report, p. 12

¹¹ Hymans Robertson report, pp. 14-15

¹² Hymans Robertson report, p. 3

¹³ Chris Rule, LPFA Chief Investment Officer, reported in *Pension Expert* on 1 October 2015

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

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

In-house management

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

Active and passive management

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

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

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

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

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

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

Improving the transparency of costs

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

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

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

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

Addressing the criterion

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

¹⁵ Hymans Robertson report, pp.10-11

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

3.57 Authorities are encouraged to provide:

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

D. An improved capacity and capability to invest in infrastructure

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

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

International experience

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

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

Creating the opportunity

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

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

¹⁶ OECD, *Annual Survey of Large Pension Funds: report on pension funds' long-term investments*, p.32, available at: <http://www.oecd.org/daf/fin/private-pensions/LargestPensionFunds2012Survey.pdf>

¹⁷ OECD report, p.14

¹⁸ Scheme Advisory Board annual report <http://www.lgpsboard.org/index.php/scheme-investments>

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

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

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

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

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

Addressing the criterion

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

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

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Chris Megainey
Deputy Director, Workforce, Pay and Pensions
Department for Communities and Local Government
Fry Building
2 Marsham Street
London
SW1P 4DF

18 February 2016

Dear Chris,

Local Government Pension Scheme: Investment Reform Criteria and Guidance (DCLG, November 2015)

1. This response to the above criteria and guidance is sent on behalf of London LGPS CIV Limited (the “**London CIV**”) and the 31 London local authorities (the “**boroughs**”, listed at Attachment 1 for reference) that are currently active participants in establishing the Collective Investment Vehicle arrangements (the “**CIV**”).
2. We note that the government requires all LGPS Administering Authorities to respond, collectively and/or individually, by 19 February 2016. We also note that this initial response should include a commitment to pooling and a description of the progress made towards that outcome. A refined and completed submission is required, and will be provided by London CIV, by 15 July 2016.
3. London Councils’ Leaders’ Committee had the foresight in 2012 to commission London Councils to facilitate work looking at what might be done to drive down the cost of pension’s investment through greater collaboration. Since then the boroughs and London Councils have been at the forefront of working through the detail and laying the ground for others that are now starting to follow in our footsteps.
4. The CIV has taken two years to implement (facilitated by London Councils, for and on behalf of the boroughs), but is now established and operational. London CIV is fully authorised by the FCA as an Alternative Investment Fund Manager (“**AIFM**”) with permission to operate a UK based Authorised Contractual Scheme fund (the “**ACS Fund**”). The ACS Fund, which is tax transparent in the UK and benefits from international tax treaties in other jurisdictions, is structured as an umbrella fund with a range of sub-funds providing access, over time, to the full range of asset classes that the boroughs require to implement their investment strategies.

5. The first sub-fund has been opened, an active global equities fund, and three authorities are the initial seed investors with £500m of assets transferred in on 2 December 2015. A further eight sub-funds, comprising a mix of active and passive equity funds, are being opened over the coming months, by the end of which it is anticipated that around £6 billion of assets will have been migrated into the ACS Fund delivering fee savings for the investing boroughs of some £3 million per annum.

6. London CIV's ambition is to be...

the investment vehicle of choice for Local Authority Pension Funds, through successful collaboration and delivery of compelling performance.

7. In summary, the key achievements we aim to deliver between now and 2020 are:

- **At least £23 billion of assets under management;**
- **Annual fund management savings rising to more than £30 million per annum;**
- **Greater access to and investment in infrastructure;**
- **Increased fund management industry influence;**
- **Wider benefits of collaboration and knowledge sharing;**

8. Turning to the specifics of the four criteria:

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

9. In consideration of the government's expectation that proposals will demonstrate commitment and be ambitious, it would seem clear that with 31 of the 33 London local authorities actively engaged in the development of the CIV such commitment and ambition is amply demonstrated.

10. The 31 boroughs participating at this time in the London CIV have assets under management, at 31 March 2015, totalling £27.6 billion. If all London LGPS funds were to participate, which it is hoped they will, total assets would increase to £29.1 billion. Clearly investment markets over the period since 31 March 2015 have been volatile and therefore assets may fall short of the above numbers. Nonetheless, if it is assumed that at least 90 per cent of borough assets will eventually be invested through the CIV (recognising that boroughs may wish to make the case for up to 10 per cent of their assets to remain outside of the CIV) then the government's threshold of each pool having assets of at least £25 billion will be met.

11. To date development of the CIV and the ACS Fund has been based on a three phase strategy as described below. This strategy reflects the principles that have been adopted to steer implementation (see Attachment 2) and the voluntary nature of participation, however it is recognised that the government's criteria and guidance have significantly changed the environment which has led to the strategy coming under review by London CIV's Board and the boroughs.

12. Despite this, London CIV and the boroughs still believe that individual boroughs should have the choice and flexibility to invest through the CIV or not, putting the onus on the CIV to demonstrate and prove its value through compelling performance, but allowing boroughs to

maintain investments outside of the CIV where they have specific needs that are not available through the Fund.

13. It should be noted that, at this stage, sub-funds will either be invested into 3rd party pooled funds or will be segregated funds with fund management being delegated to 3rd party Investment Managers (“IM”). However, London CIV is fully authorised to operate in-house fund management and this option will be explored at a later stage to assess whether it would deliver additional efficiencies and performance.

Phase 1 – Implementation and fund launch

14. Phase 1 is being delivered through what has become known as the “commonality” strategy. This broadly involves seeking to aggregate borough investments where two or more boroughs are invested with the same IM in the same or a very similar mandate, the aim being to increase efficiency and drive down cost.
15. The commonality strategy is a pragmatic approach that quickly delivers scale benefits for the boroughs and fee income for London CIV to cover operating costs.
16. Phase 1 is the prime focus of activity in terms of fund opening through the first half of 2016.
17. Implementation of the strategy began with the analysis of investment data gathered from across the boroughs in 2014, the aim of which was to discover which IMs the boroughs were invested through, in what asset classes and the underlying mandate strategies. This analysis showed that the 33 funds had holdings with close to 90 IMs through around 250 separate mandates. It also showed that while there was significant commonality in some asset classes (e.g. passive equity) other classes (e.g. fixed income) showed a high degree of dispersion.
18. Early discussions were held with 14 IMs where commonality could be seen, but over time, as the detail was explored, all but four decided to drop out of the process or were discounted. There were several influencing factors for this, the most prevalent of which was capacity constraint, but also included an unwillingness to reduce fees, especially for those IMs that have a ‘most favoured nation’ clause in their mandates.
19. In summary, the launch phase will deliver nine sub-funds:
 - 2 x UK passive equity
 - 2 x World Developed ex UK passive equity
 - 2 x Emerging Markets passive equity
 - 1 x Diversified Growth Fund (hard closed but nonetheless delivering lower fees for the boroughs currently invested)
 - 2 x Global active equity
20. In aggregate, the Phase I sub-funds will account for £6.1bn, or around 23% of the boroughs’ total assets under management and will involve 20 of the 31 participating authorities.
21. Total fee savings are estimated to be a minimum of £2.8 million per annum (simply through reduced IM Annual Management Charges) but could be £3 million or more per annum based

on assumptions about additional benefit derived from the tax efficient nature of the ACS Fund structure. These fee savings will not be spread equally across all the boroughs and this is largely influenced by each borough's current fee position – some boroughs have negotiated better fees than others at this point.

22. It should be noted that since passively managed equities generally have low fee scales, the ratio of fee savings to assets under management (“**AUM**”) will increase as the more ‘alternative’ investments such as property and private equity are brought onto the fund.
23. In addition to the fee charged by each IM the London CIV will also apply a fee to each sub-fund as part of the company's cost recovery. These charges are applied at a rate appropriate to the nature of each sub-fund and range from 0.005% for the UK passive equity funds to 0.025% for the active funds.

Phase 2 – Establishing London CIV and developing the ACS Fund

24. The strategy for Phase 2, which has already commenced but with implementation starting in 2016-17, falls into two categories:
 - i. Revisiting the Phase I ‘commonality’ strategy with those IMs that had early discussions but did not progress; and
 - ii. Beginning the process of developing the fund with new manager selections in new asset classes.
25. In addition, the original nine launch sub-funds will be opened to investment from ‘new’ investors enabling any of the 11 boroughs (and indeed any other LGPS Fund) not included in the launch phase to transition assets from their current holdings should they wish to.
26. Attachment 3 presents analysis of the boroughs’ current allocation by asset class, and from this it can be seen that the major asset classes by AUM are equities (active and passive), fixed income (active and passive) and multi-asset.
27. Category (i) will essentially follow the same process as was described in Phase I and will be applied to four Multi-Asset managers and, subject to on-going discussions with IMs and potentially one further passive equity manager.
28. The Multi-Asset products are significantly heterogeneous, and therefore it is sensible to present a fairly wide range of choice to the boroughs so that they can select a strategy which fits their particular risk appetite and investment strategy.
29. Category (ii) is driven by analysis of the borough's current holdings and the need to build AUM to deliver fee income that supports London CIV's operating costs. By reference to Attachment 3 it is clear that the focus should be on targeting the remainder of the passive and active equity assets and opening initial opportunities for Fixed Income sub-funds.
30. Passive Fixed Income mandates will be targeted in 2Q 2016-17. Earlier data collected from the boroughs suggests that the Fixed Income asset class has little in the way of commonality and conviction, so on current projections there may be approximately £500 million being transitioned each for Active and Passive. However, the active fixed income mandates are

likely to require more intensive search and selection, and therefore the bulk of the fixed income mandates will fall into the Phase 3 category (below).

31. It is anticipated that every participating borough will have opportunities to migrate to the CIV by March 2017.
32. As currently planned Phase 2 will conclude by March 2018. In terms of AUM, the end of Phase 2 will deliver an estimated £19 billion or 70 per cent of borough assets. However, the government should note that the opening of sub-funds is complex and time consuming and growth at that pace cannot be guaranteed.

Phase 3 – Business as Usual (“BAU”)

33. BAU will be focussed initially on a continuation of developing the fund’s offering and then its ongoing maintenance and enhancement. This phase will include:
 - i. Opening of new asset classes (e.g. infrastructure);
 - ii. The ongoing process of monitoring sub-funds, closing poor performers and opening new offerings; and
 - iii. Development of the CIV’s role in ‘thought leadership’ and being seen as a trusted source of support and advice for the boroughs.
34. Phase 3 could be seen as starting from April 2018 (i.e. the end of Phase 2), but in reality the transition from Phase 2 to Phase 3 is unlikely to be linear and there will be an overlap.
35. The successful migration of the boroughs’ fixed income mandates together with the other mandates as detailed above, will lead to the asset base of London CIV increasing to an estimated £23 billion, or 86 per cent of total borough assets, by the end of 2019-20. Growth to the £25 billion threshold would be expected to happen over the following two or three years as more alternative asset classes are addressed.
36. Based on the fact that we are seeing fund management costs dropping by as much as 50 per cent (and in some cases more), and that we expect to have more negotiating power as the Fund develops, we expect to be delivering in the region of £30 million of fund management savings by 2020 (based on current fund management costs of £109 million). In addition we will be delivering other savings and benefits through greater tax efficiency, reduced procurement costs and lower fees for, for example, custody and brokerage.
37. In considering the extent to which boroughs may hold assets outside of the CIV, it can be seen from Attachment 3 that around 10 per cent of assets are held in property, private equity and infrastructure and it is in these asset classes that one would expect to find long term investments that may take several years to mature before transition to the CIV. It is of course for individual boroughs to make the case to government for holding assets outside of the CIV.
38. London CIV is focussed on delivering value for money for the participating boroughs and as such resources are tight and many tasks and activities are outsourced to 3rd parties. London CIV’s current organisational structure is shown at Attachment 4. This in-house resource is augmented by expertise provided by members of the IAC (see paragraph 38) and the use of

3rd party providers including the Custodian, the Depositary, the Operating Reporting Partner, and Investment Consultants and Advisors.

39. Over time the level of resource will increase and more activity will be brought in-house, which might include in-house fund management. The company's business strategy is being reviewed at this time and more detail will be provided in the July submission.

B. Strong Governance and decision making:

40. Attachment 4 provides a diagram of the core governance structures for the CIV. Strong governance and mechanisms to ensure that participating boroughs have the assurance that they need to be confident that their investments are being managed appropriately by the pool have been critical factors in the design of this structure.

41. Taking each of the core governance structures in turn; the participating local authorities (London boroughs and potentially other non-London funds) continue to be responsible for their investment strategy and the asset allocation decisions to deliver it. As the CIV's ACS Fund develops the expectation would be that more and more of the underlying investments would be made through the CIV. Each participating borough is an equal shareholder in London CIV and a signatory to the Shareholders Agreement that sets out the relationship between and the responsibilities of each shareholder.

42. Representing the borough level, a Sectoral Joint Committee ("**PSJC**") has been established under the governing arrangements of London Councils. The PSJC effectively fulfils two roles, one is as a mechanism for convening elected Member representation from each borough (generally the borough's Pension Committee Chair), and the other is as the route to convening the boroughs as shareholders in London CIV. The committee meets most often in its first guise and has met five times since December 2014 to provide oversight and guidance as the CIV has been established. Going forward the PSJC will be the channel through which borough views about how the ACS Fund might be developed will be passed to London CIV and as a general reporting route for London CIV back to the boroughs. The committee's Terms of Reference are provided as Attachment 5. Agendas and minutes of the PSJC are published on London Councils' website and its meetings are held in public.

43. Alongside the PSJC an Investment Advisory Committee ("**IAC**") has been established. This committee is comprised of representative borough Treasurers and Pension Fund Managers, and provides Officer level input to the oversight and development of London CIV.

44. These two committees ensure that the links with local democratic accountability for the London CIV are maintained.

45. The CIV itself is comprised of two parts, the operating company (London LGPS CIV Limited) and the ACS Fund, this structure is described in brief at paragraph 4 above.

46. As government will be aware, London CIV already has dedicated resources working for the company with a Chief Executive, Investment Oversight Director, and Chief Operating Officer, as well as support staff. In addition the Company has a highly respected Non-Executive Board in place, meeting the requirements for strong governance arrangements to be in place.

47. As an AIFM London CIV must comply with the Alternative Investment Manager Directive (“**AIFMD**”) and falls under the regulatory scrutiny and reporting regime of the Financial Conduct Authority (“**FCA**”). This includes the requirement for robust systems and processes and for these to be documented appropriately in policies and manuals. Risk management is a particular focus for the FCA and London CIV has developed a risk framework and risk register covering all areas of its operations, including fund management.
48. In addition to the oversight and scrutiny arrangements described above, it is a requirement for London CIV to engage a Depositary to provide oversight of the Fund Custodian and London CIV as the fund operator. Northern Trust have been contracted to provide this service, which is effectively there to provide additional assurance and protection to the boroughs as investors.
49. As described above the participating boroughs will be closely involved in the development of the ACS Fund, including in the decisions about what new sub-funds might be opened and in what asset class. The IAC is also expected to be involved in the search and selection process for IMs. However, the final due diligence consideration and appointment of IMs falls under the regulatory responsibilities of London CIV through its Investment Oversight Committee and Board. Boroughs will decide which of the sub-funds they wish to invest in to best deliver their investment strategy.
50. The processes for London CIV to report on fund performance to the investing boroughs are still being developed, but in broad terms will include regular written and verbal reports to the PSJC, the IAC and to individual borough Pension Committees as required. However, the development of final arrangements for reporting is likely to be an iterative process to ensure that they are efficient and fit for purpose for both the investors and for London CIV. It is the intention that every borough will receive performance reporting across every sub-fund (regardless of whether they are invested in that sub-fund or not), in this way boroughs will be able to easily compare performance of sub-funds they are invested in with other similar sub-funds.
51. With regards to providing assurance on environmental, social and governance issues and how this will be handled by the CIV, this has already been the subject of consideration by the company and the PSJC with an agreement that the London CIV should be a separate member of the Local Authority Pension Fund Forum (the “**LAPFF**”) – a body which represents the majority of views of local authority pension funds on these matters. Discussions have commenced with the LAPFF to put this arrangement in place.
52. London CIV is also currently considering how it will meet the requirements of the Stewardship Code and anticipates being a signatory to this in due course.
53. The IAC has also established a working group to look at the whole issue of ESG matters and how funds can best access this through the London CIV and how to assist funds in acting as long term responsible shareholders.
54. For individual funds, they will of course need to maintain their own policies in respect of ESG matters and this will comprise part of their new Investment Strategy Statement which replaces the Statement of Investment Principles later this year.

C. Reduced costs and excellent value for money:

55. London CIV anticipates significant fee savings arising over time, from scale and increased negotiating power with managers. As described above, Phase 1 of the Fund development is expected to deliver around £3 million of savings p.a. for the 20 boroughs that will be invested. It should be recognised that the first phase represents relatively low cost asset classes with the majority being in passive asset classes, it is inevitable that as more complex and expensive assets are added then fee savings will significantly increase. To date London CIV has seen fee reductions of up 50 per cent.
56. In addition to the anticipated fee savings, we also expect to accrue significant advantages from the tax transparent nature of the ACS structure and savings across the entire spectrum of investment costs, including reduced custodian fees, lower procurement costs etc. In 2012 the Society of London Treasurers in 2012 had the foresight to commission a report from PWC that estimated that an additional £85 million could be derived in terms of improved investment returns by delivering superior performance. Whilst clearly this figure is open to some debate, it does give an indication of what might be achieved for funds through greater collaboration and delivering improved performance overall.
57. London CIV will be working with the participating boroughs to gather the data necessary to provide the requested assessment of investment costs and fees as at 31 March 2013, the current position and estimated savings over the next 15 years. This information will be provided in the July submission.
58. Transition costs are complex and extremely difficult to estimate in isolation from the case by case detail of each specific transition. Costs in this area can accrue from fees (e.g. transition managers, custodians and tax advisors) and transaction costs (e.g. the cost of buying and selling assets, including unavoidable tax in some jurisdictions). London CIV is working hard to bear down on transition costs and will continue to do so. It is anticipated that more detail can be provided in the July submission.
59. In addition to reduced costs and fees the wider governance benefits from information sharing and improved access to expertise at all levels should not under estimated as significant advantages from collaboration.
60. LGPS funds clearly understand the need to look at the risk adjusted returns over the longer time frame and that it is the net value-add that impacts on the fund's ability to pay pensions over the longer term. It is clear that avoiding knee jerk reactions when managers experience periods of underperformance is an important factor and we are pleased to see the government has recognised this in asking for funds to consider what is achieved over an appropriate long term period, rather than solely focusing on short term performance comparisons. London CIV is firmly of the view that 'churn' of IMs will be reduced through the CIV as part of the enhanced governance arrangements and knowledge sharing that is being established.

D. An improved capacity to invest in infrastructure:

61. One of the big opportunities from creating the CIV is the potential to use the benefit of scale to enable the boroughs to access infrastructure as an asset class. London CIV and the

boroughs have begun to consider infrastructure as an asset class and what different and innovative approaches might be taken to deliver benefits both in London and nationally. Detailed proposals are likely to fall towards the end of Phase 2 of our development. Early discussions have been had with a number of IMs in this area and also with the Pensions Infrastructure Platform.

62. As can be seen from Attachment 3, LGPS funds across London currently have little or no assets invested in infrastructure. Most boroughs have limited resources to dedicate to considering this complex asset class and experience shows that there is a general lack of suitable investments at the scale that the average borough would wish to invest and with the required risk/return profile. However, there appears to be no evidence that any London LGPS fund is strategically opposed to infrastructure investment as an asset class per se.
63. Nonetheless, pooling of each borough's allocation to infrastructure and opening the opportunity for those that currently have no allocation will generate a greater capacity to invest, enabling the CIV to look at opportunities either direct or as co-investments that would not have been open to individual funds, often simply because of the cost of entry.
64. Determining the proportion of assets to allocate to infrastructure will be a decision for each investor to take as part of their Asset Allocation strategy. These decisions will depend on the opportunities that can be made available and on the level of risk and reward generated from those opportunities when compared against risk/reward in other asset classes.

In conclusion

65. London CIV believes that the work that has been undertaken by those London Boroughs that have contributed to the development of the CIV demonstrates a clear commitment to the principles of collaboration and collectivisation. The creation of London CIV has been instrumental in driving forward the investment reform agenda in London. The scale of asset pooling that we anticipate will be achieved in London is sufficiently large for the London CIV to meet the criteria for scale over the timescales being required. We believe that we have developed both the appropriate structure for London funds and that the governance structures in place mean that local accountability and decision making on asset allocation are retained.
66. Consequently we strongly believe given the willingness shown and progress made by the London funds over the last 2 years means that we are able to meet the criteria to be confirmed as one of the final pools of assets under the government's reform agenda.
67. We recognise that further work is required, but that London CIV and the participating boroughs are in a strong position to be able to come forward with comprehensive proposals to meet the government's criteria and guidance when submitting these in July 2016.
68. Despite the scale, complexity and untested nature of the London boroughs collaborations, the London CIV has successfully navigated these challenges and is now well on the way to achieving the government's four criteria of scale, costs savings, governance and access to infrastructure

Local Government Pension Scheme: Revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the “Regulations”)

69. It is recognised that in application the Regulations do not apply directly to London CIV but do determine the way that the boroughs manage and invest their funds and therefore have an influence over how London CIV and its investors will operate in the future. As such London CIV expects that each borough will respond to the consultation and this response only covers issues that relate, or could relate to London CIV specifically.
70. London CIV is broadly supportive of relaxing the regulatory framework for LGPS investments and the move to a ‘prudent’ basis, but as a principle does not support wide ranging powers for the Secretary of State to intervene. This concern about powers of intervention is especially true in circumstances where the guidance setting out how the power will be used has not been published.
71. In the context of LGPS Funds being required to invest through pooling arrangements (e.g. London CIV) it is not clear whether the Funds would be required to apply Section 9 of the Regulations when deciding to invest through a pool. London CIV is structured as a Private Limited Company (wholly owned by the participating authorities) and is authorised by the FCA as an AIFM with permission to operate an ACS, effectively this means that London CIV is an Investment Manager. London CIV believes that ‘recognised’ pools should be explicitly addressed in the regulations to avoid confusion, prevent unnecessary bureaucracy and to give reassurance to individual LGPS Funds – especially in this period of change.
72. In addition, London CIV is of the view that care should be taken over the wording of Section 7(4) which, as currently drafted, may have the effect of preventing LGPS Funds from investing in pools where Members or officers of the authority have decision making roles in those pools as a part owner of that pool. Again specific measures relating to recognised pools would provide clarity.
73. On the question of the use of derivatives; it should be recognised that derivatives can be used to control outcomes in many ways, it is not just about risk per se. Derivatives can be used to produce more certain outcomes, be more efficient as an instrument to use as an investment than an actual asset due to increased liquidity and visibility of pricing; be more liquid than some real assets might be; and allow investment managers to reflect macro-economic views without having to churn large parts of the portfolio. Although controlling these outcomes is all about balancing risk and return it is not just risk management – there is a clear difference between the two and accordingly we would urge that the regulations should not be explicit that derivatives should only be used as a risk management tool.

London CIV would welcome the opportunity to discuss this submission in more detail with government officials and Ministers.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Hugh Grover', with a long horizontal flourish extending to the right.

Hugh Grover
Chief Executive

Hugh.grover@londonciv.org.uk
020 7934 9942

Attachment 1: Participating local authorities

City of London Corporation
London Borough of Barnet
London Borough of Barking and Dagenham
London Borough of Bexley
London Borough of Brent
London Borough of Camden
London Borough of Croydon
London Borough of Ealing
London Borough of Enfield
London Borough of Hackney
London Borough of Haringey
London Borough of Harrow
London Borough of Hammersmith and Fulham
London Borough of Havering
London Borough of Hounslow
London Borough of Islington
London Borough of Lambeth
London Borough of Lewisham
London Borough of Merton
London Borough of Newham
London Borough of Redbridge
London Borough of Southwark
London Borough of Sutton
London Borough of Tower Hamlets
London Borough of Waltham Forest
London Borough of Richmond upon Thames
Royal Borough of Greenwich
Royal Borough of Kensington and Chelsea
Royal Borough of Kingston upon Thames
Wandsworth London Borough Council
Westminster City Council

Attachment 2: London CIV guiding principles

1. Investment in the ACS should be voluntary, both entry and withdrawal.
2. Boroughs choose which asset classes to invest into, and how much.
3. Boroughs should have sufficient control over the ACS Operator.
4. Investing authorities will take a shareholding interest in the Operator.
5. Shareholders will have membership of the Pensions Joint committee.
6. ACS Operator will provide regular information to participating boroughs.
7. ACS will not increase the overall investment risk faced by boroughs.

Attachment 3: Analysis of current borough holdings

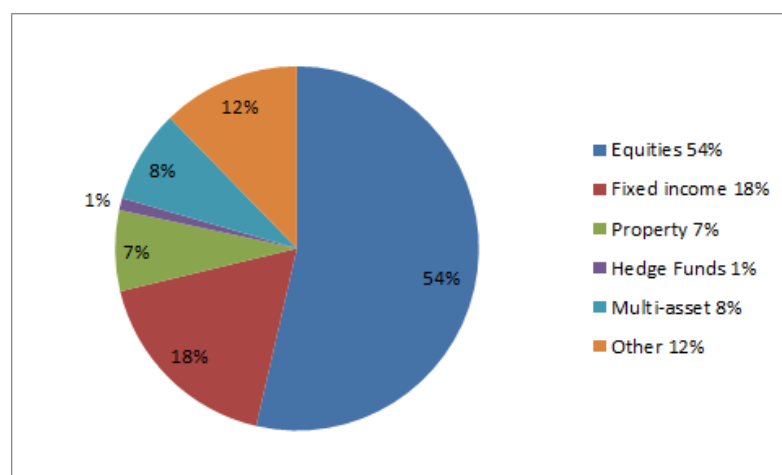
Current asset allocation

The breakdown of the pension fund assets as of 31 March 2015 for the 31 participating London boroughs can be seen below:

Table 1

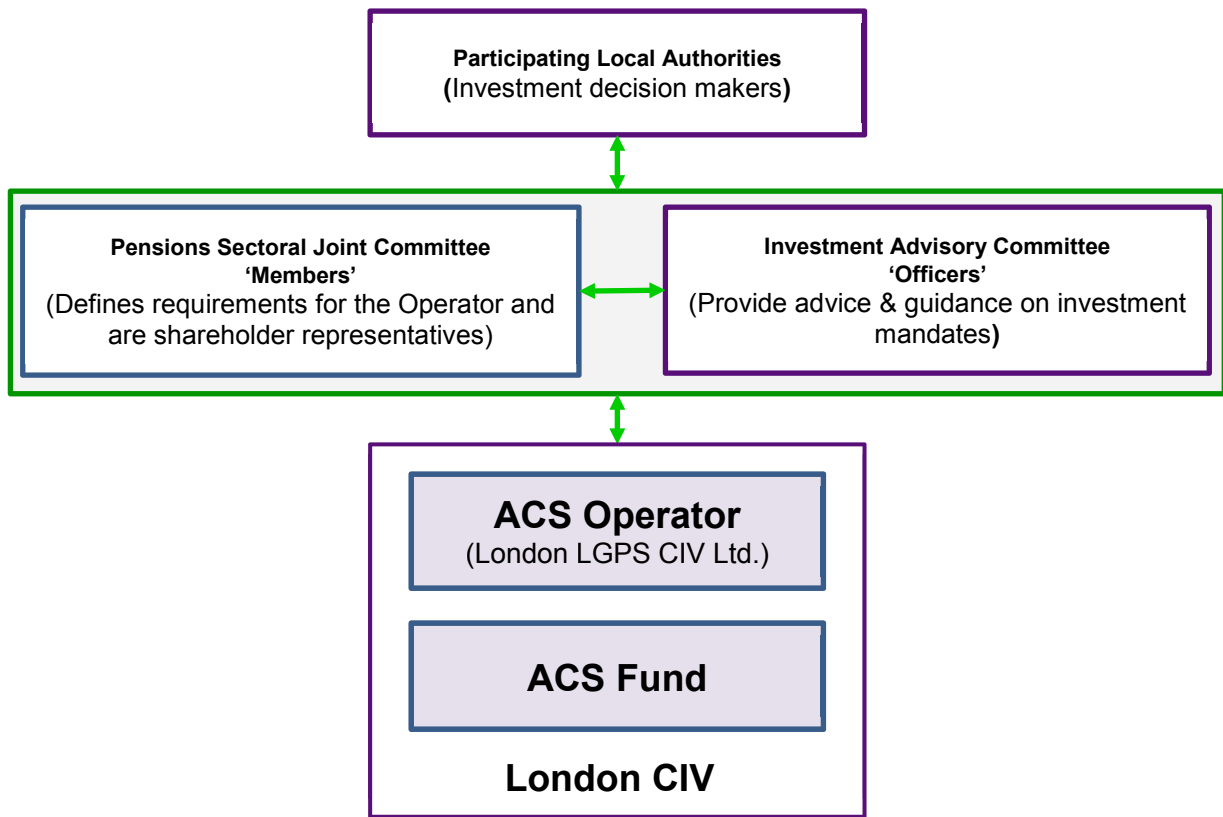
Allocation	£m, March 2015	Percentage
UK equities	5,077.39	18.9%
overseas equities	6,560.63	24.4%
unallocated	2,748.31	10.2%
total equities	14,386.33	53.6%
UK fixed interest	2,636.29	9.8%
overseas fixed interest	808.32	3.0%
unallocated	863.04	3.2%
total fixed interest	4,307.65	16.0%
UK index linked	312.52	1.2%
overseas index linked	30.01	0.1%
unallocated	80.43	0.3%
total index linked	422.96	1.6%
UK property	1,350.87	5.0%
overseas property	56.85	0.2%
unallocated	517.01	1.9%
total property	1,924.73	7.2%
UK hedge funds	32.40	0.1%
overseas hedge funds	-	0.0%
unallocated	256.56	1.0%
total hedge funds	288.96	1.1%
UK other	783.74	2.9%
overseas other	963.62	3.6%
Multi-asset	2,214.31	8.2%
Total unallocated	3,961.67	14.8%
infrastructure	193.53	0.7%
commodities	57.43	0.2%
private equity	525.05	2.0%
derivatives	- 2.28	0.0%
currency overlay	-	0.0%
cash	777.37	2.9%
Total investment assets	26,843.38	100.0%

NB the multi-asset allocation is done on a "best efforts basis" due to conflicting and out of date data.

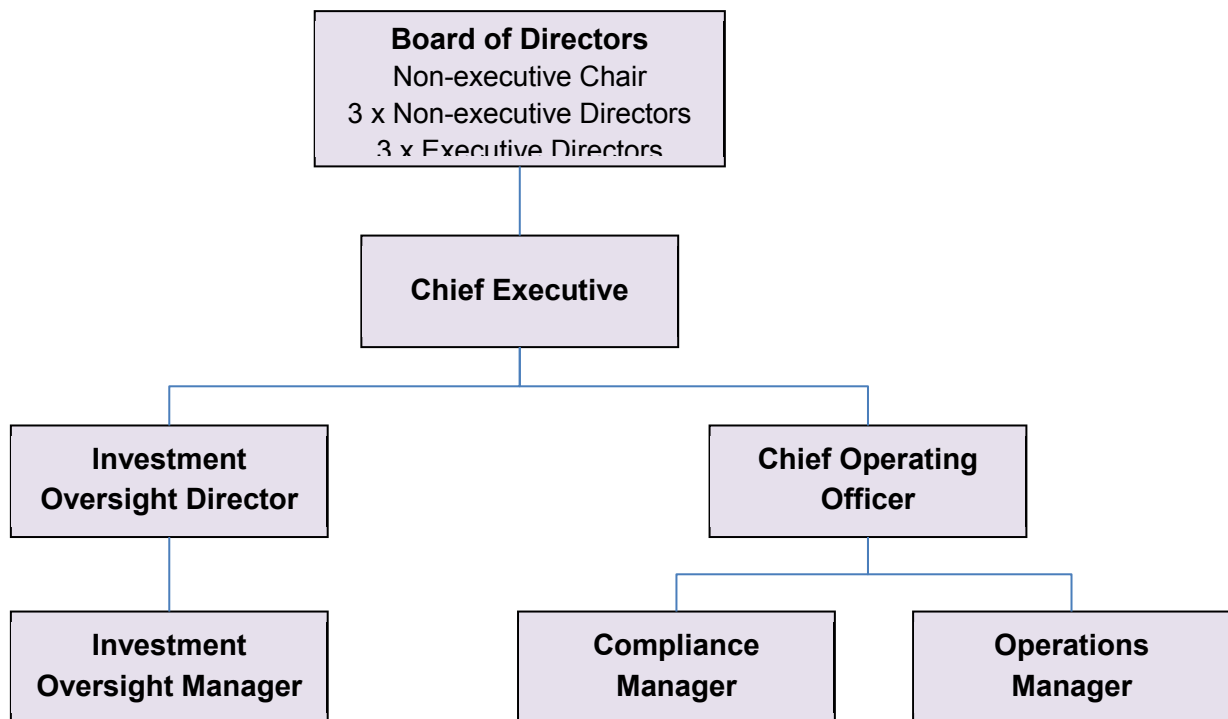


Attachment 4:

London CIV governance diagram



London CIV organisation chart



Attachment 5: Pensions Sectoral Joint Committee Terms of Reference

Constitution

- 1.a.1 The Pensions CIV Joint Committee is a sectoral joint committee operating under the London Councils governance arrangements.¹
- 1.a.2 Each London local authority participating in the arrangements shall appoint a representative to the Pensions CIV Joint Committee being either the Leader of the local authority or the elected mayor as applicable or a deputy appointed for these purposes.²
- 1.a.3 The Pensions CIV Joint Committee shall appoint a Chair and Vice-Chair.
- 1.a.4 The Pensions CIV Joint Committee shall meet at least once each year to act as a forum for the participating authorities to consider and provide guidance on the direction and performance of the CIV, In addition, members of the Pensions CIV Joint Committee shall meet at least once each year at an Annual General Meeting of the ACS Operator in their capacity as representing shareholders of the ACS Operator.
- 1.a.5 Subject to Clause 1.1.4 above, meetings of the Pensions CIV Joint Committee shall be called in accordance with London Councils' Standing Orders and the procedure to be adopted at such meetings shall be determined in accordance with those Standing Orders.
- 1.a.6 If the Pensions CIV Joint Committee is required to make decisions on specialist matters in which the members of the Pensions CIV Joint Committee do not have expertise the Pensions CIV Joint Committee shall arrange for an adviser(s) to attend the relevant meeting to provide specialist advice to members of the Pensions CIV Joint Committee.

Quorum

- 1.a.7 The requirements of the Standing Orders of London Councils regarding quorum and voting shall apply to meetings of the Pensions CIV Joint Committee.

¹ The London Councils' Governing Agreement dated 13 December 2001 (as amended), London Councils' Standing Orders, Financial Regulations and other policies and procedures as relevant.

² Clause 4.5 of the London Councils' Governing Agreement dated 13 December 2001 (as amended).

Membership

[As amended from time to time]

Terms of Reference

1.a.8 To act as a representative body for those London local authorities that have chosen to take a shareholding in the Authorised Contractual Scheme (ACS) Operator company established for the purposes of a London Pensions Common Investment Vehicle (CIV).

1.a.9 To exercise functions of the participating London local authorities involving the exercise of sections 1 and 4 of the Localism Act 2011 where that relates to the actions of the participating London local authorities as shareholders of the ACS Operator company.

To act as a forum for the participating authorities to consider and provide guidance on the direction and performance of the CIV and, in particular, to receive and consider reports and information from the ACS Operator particularly performance information and to provide comment and guidance in response (in so far as required and permitted by Companies Act 2006 requirements and FCA regulations).

1.a.10 In addition, members of the Pensions CIV Joint Committee will meet at least once each year at an Annual General Meeting of the ACS Operator to take decisions on behalf of the participating London local authorities in their capacity as shareholders exercising the shareholder rights in relation to the Pensions CIV Authorised Contractual Scheme operator (as provided in the Companies Act 2006 and the Articles of Association of the ACS Operator company) and to communicate these decisions to the Board of the ACS Operator company. These include:

1.a.10.1 the appointment of directors to the ACS Operator board of directors;

1.a.10.2 the appointment and removal of auditors of the company;

1.a.10.3 agreeing the Articles of Association of the company and consenting to any amendments to these;

1.a.10.4 receiving the Accounts and Annual Report of the company;

1.a.10.5 exercising rights to require the directors of the ACS Operator company to call a general meeting of the company;

Dear Sirs

I refer to the consultation document "Local Government Pension Scheme: Investment Reform Criteria and Guidance" issued in November 2015.

On behalf of the London Borough of Harrow Pension Fund I confirm that we have a commitment to pooling and have joined London LGPS CIV Ltd. We are happy to be associated with their response to you sent earlier today.

For the sake of completeness I attach a copy of the CIV response

Dawn

Dawn Calvert, Director of Finance (Section 151)
Harrow Council

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Pensions CIV Sectoral Joint Committee

Item no: 5

London CIV Progress Update

Report by: Hugh Grover

Job title: Chief Executive
London LGPS CIV Ltd.

Date: 10 February 2016

Contact Officer:

Telephone: 020 7934 9942

Email: hugh.grover@londonciv.org.uk

Summary

This report provides the Committee with updates covering programme implementation, general progress as London CIV moves into 'business as usual' and the high-level programme risk register for consideration.

Recommendations

The committee is recommended to:

- i. Consider and note the contents of this report.
-

London CIV Progress Update

Introduction

1. The Committee last received a report on progress towards establishing the London CIV at its meeting of 4 November 2015. Since then significant progress has continued to be made and this report provides an update to Members covering the major achievements over the last three months.

Progress

2. Major items to note are:
 - **Borough participation:** in November 2015 the 31st London local authority (LB Havering) became an active participant in the London CIV programme. Timing of report drafting and distribution prevented this being reported to the last meeting.
 - **Fund authorisation:** the Committee's last update noted that the Company (London CIV) had been authorised by the FCA on 15 October 2015 and that the Fund application for authorisation had been submitted. It can now be reported that the Fund was authorised on 13 November 2015. Achieving this milestone made London CIV the first full-scope Alternative Investment Fund Manager (AIFM) in local government and the first to be authorised to operate an Authorised Contractual Scheme Fund (ACS). This achievement is the result of more than two years of collaboration across the London boroughs facilitated by London Councils.
 - **Fund launch:** the first sub-fund (London LGPS CIV Global Alpha Growth Fund), managed by AllianzGI under delegated management, opened on 2 December 2015. The 'seed' investors are LBs Ealing, Islington and Wandsworth. The fund has £500 million of assets under management from three participating boroughs. There are eight further sub-funds to open to complete the 'launch' phase and the next two will be a Diversified Growth Fund and another Active Global Equities Fund under the management of Baillie Gifford.

It is becoming clear that opening the six passive equity sub-funds involves some complex issues that are taking longer to resolve than first anticipated. Seminars are being organised with officers of the boroughs involved to discuss the issues and to keep them in touch with progress. As the bulk of assets for the launch phase sit within the passive asset class there is a knock-on impact on the company's cost recovery model, this is being modelled. London CIV officers are stepping up the process of discussing with Fund Managers the potential to open other sub-funds sooner than previously planned.

- **Business strategy development:** now that the implementation phase is drawing to a close, and the light of the government's LGPS reform criteria and guidance, London CIV's Board has begun the process of revisiting and refining the company's business strategy through to 2020. The strategy will be presented to the Committee for consideration at the next meeting.
- **Board appointments:** following the last Committee meeting one of London CIV's Board members, Lisa Arnold, resigned due to other commitments. The Board has been working with Odgers Berndtson to recruit a suitably qualified replacement and

interviews are being scheduled for 18 February 2016, due regard is being paid to diversity issues in making this appointment.

- **Implementation programme closure:** implementation of London CIV is drawing to a close and the implementation budget is being reviewed. A report will be submitted to the next Committee meeting but indications are that costs have been maintained within budget.
- **Engagement with the FCA:** on 22 January London CIV's CEO, COO and Eric Mackay (Non-executive Director) presented to over 30 staff of the FCA on the formation of the CIV and the wider LGPS reform agenda. This level of engagement from the regulator is very unusual and a clear indication that they are very interested in ground breaking nature of what the London boroughs and London CIV have achieved.

The CEO and COO of London CIV met with officers of the FCA to discuss the impact of MiFID II and what options might be pursued to mitigate the effects of the Directive on local government. It was a productive meeting giving both sides a greater understanding of the issues on each side. Enactment of the Directive has been postponed for a year giving more time for further discussions.

The FCA has announced that they are to undertake a review of the Investment Management industry and Investment Consultants. Indications are that London CIV will be asked to participate in the evidence gathering phase of this review. The specific questions they are seeking address are:

- whether investors find it difficult to monitor asset managers and ensure they are getting value for money;
- whether potential conflicts of interest arise from the provision of both advice and asset management services by investment consultants;
- whether asset managers have the incentive and ability to control costs incurred on behalf of investors along the asset management value chain effectively;
- whether the bundling of some ancillary services affects the provision and quality of services provided.

Risk Register

3. The current implementation risk register is attached at Annex A for consideration, significant updates are:
 - **Risks 1a, 1b, 4 & 5:** these risks have been closed.
 - **Risk 3:** the 'Likelihood' factor of this risk has been reduced to 2, reducing the 'Outcome' rating to 4 as experience has shown that boroughs are generally very engaged and able to make the necessary transition decisions on time.
 - **Risk 8:** this risk has been added at the request of the Committee.
4. The programme risk register will be closed as part of the overall programme closure process. London CIV has developed a company risk register which is under review by the Compliance Audit & Risk Committee before going to the Board for formal ratification. The finalised risk register will be brought to the next meeting of this Committee for information.

Recommendations

5. The committee is recommended to:
 - i. Consider and note the contents of this report.

Financial implications

6. There are no financial implications for London Councils

Legal implications

7. There are no legal implications for London Councils

Equalities implications

8. There are no equalities implications for London Councils

Risk Register											
Responsibility		London CIV Programme Office									
Date last reviewed		01/02/2016									
Reviewed by		Hugh Grover									
No	Risk	Risk Type	Risk description	Risk Rating without control (1-4)			Controls in place	Responsible Officer	Risk rating with control (1-4)		
				L	I	O			L	I	O
1.	FCA Authorisation	External; & Reputational	1a) Risk that FCA will delay the CIV application	2	3	6	- Expert advisors engaged for application. - Meetings with FCA to discuss proposal.	Hugh Grover	2	2	4
			1b) Risk that FCA will reject the CIV application	4	4	4	- Expert advisors engaged for application. - Meetings with FCA to discuss proposal.		4	3	3
2.	Borough engagement	External; & Reputational	Risk that any serious delays in the CIVs launch will result in some of the boroughs withdrawing their support	2	2	4	- Frequent communications with senior borough officers and SLT. - Engagement with members through the PCJC and other communications.	Hugh Grover	1	2	2
3.	Borough investment decision making	Project	Risk that the borough committees will not take the decision to invest through the CIV and delay sub fund launches.	3 2	2	6 4	- communicate critical timeframes to boroughs. - understand and respond to individual borough needs. - Boroughs being encouraged to seek delegated decision making powers for the s.151 (Finance Director).	Hugh Grover	1	2	2
4.	Company infrastructure	Operational	Risk that infrastructure is not established within launch timeline	2	3	6	- Project plans in place to deliver infrastructure within timeframe.	Hugh Grover	4	2	2

5.	Government action	Project	Risk that government may decide to take its own actions to reform the LGPS and that the CIV may not be part of those reforms	1	4	4	<ul style="list-style-type: none"> - maintain regular contact with Ministers and civil servants. - maintain high profile of the CIV. 	Hugh Grover	1	4	4
6.	Not delivering savings	Financial & reputational	Risk that the CIV will not deliver savings to the participating boroughs	1	4	4	- Ensure focus on delivering savings.	Hugh Grover	1	3	3
7.	Unexpected costs	Financial & project	Risk that programme implementation costs will exceed budget due to unexpected costs	1	2	2	<ul style="list-style-type: none"> - Robust financial system and regular budget review. - Ensure VFM is gained from every 3rd party contract. 	Hugh Grover	1	2	2
8.	The impact of MiFID II on the boroughs	Operational	Risk that when boroughs are downgraded to 'Retail' investors they will not be able to invest through the CIV	3	4	12	- Maintain dialogue with the FCA to ensure that they deliver a workable outcome.	Hugh Grover	2	4	8

REPORT FOR: Pension Fund Committee

Date of Meeting:	9 March 2016
Subject:	Information Report – Annual Review of Internal Controls at Fund Managers
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	Appendix – Review of Internal Controls at Fund Managers

Section 1 – Summary

The report sets out in summary the contents of the latest internal controls reports of each of the Fund Managers.

FOR INFORMATION

Section 2 – Report

1. The Report of the Auditor on the Pension Fund's 2009-10 Accounts recommended that due diligence be carried out on the strength of the operational controls at investment managers both through a review of internal controls reports and visits to key investment managers. At the November 2010 meeting of the, then, Pension Fund Investment Panel a

template was introduced as a basis for measuring the level of assurance provided by the operational structure supporting each mandate.

2. Operational controls of investment managers relate to the procedures in place to safeguard the Fund's assets against loss through error or fraud and to ensure that client reporting is accurate. Poor operational controls can also hamper the management of the assets leading to reduced returns or increased costs. Should there be a lack of evidence that controls operated by investment managers are robust the continued appointment of the manager would be questionable.
3. Operational control reviews focus on the key environmental, business and process issues. A summary of the findings from the most recent reviews is provided in the Appendix. The key points from the findings in respect of the Fund's current managers are as follows:

Aviva Investors

The audit, carried out by PricewaterhouseCoopers LLP, indicates that controls are operating effectively and where shortcomings have been identified that there has been a satisfactory management response.

BlackRock Inc

The audit, carried out by Deloitte and Touche LLP, indicates that controls are operating effectively and, where shortcomings have been identified, that there has been a satisfactory management response.

GMO

The audit, carried out by PricewaterhouseCoopers LLP, indicates that controls are operating effectively and, where shortcomings have been identified, that there has been a satisfactory management response.

Insight Investment

The audit carried out by KPMG LLP indicates that controls are operating effectively and, where exceptions have been identified, that there has been a satisfactory response.

Longview Partners LLP

The audit, carried out by Moore Stephens LLP, indicates that controls are operating effectively and that no control shortcomings were identified.

Oldfield Partners LLP

The audit, carried out by Deloitte LLP, indicates that controls are operating effectively and that no control shortcomings were identified.

Pantheon

The audit, carried out by KPMG LLP, indicates that controls are operating effectively and that no control shortcomings were identified.

Record Currency Management Ltd

The audit, carried out by Grant Thornton UK LLP, indicates that controls are operating effectively and that no control shortcomings were identified.

Standard Life Investments Inc

The audit carried out by KPMG LLP indicates that controls are operating effectively and, where exceptions have been identified, that there has been a satisfactory response.

State Street Global Advisors

The audit, carried out by Ernst and Young LLP, indicates that controls are operating effectively and, where shortcomings have been identified, that there has been a satisfactory management response.

Financial Implications

4. Whilst the performance and effective controls of the fund managers is of paramount importance in the performance of the Pension Fund , there are no financial implications arising from this report.

Risk Management Implications

5. The risks arising from investment performance are included in the Pension Fund risk register.

Equalities implications

6. There are no direct equalities implications arising from this report.

Council Priorities

7. Investment performance has a direct impact on the financial health of the Pension Fund which directly affects the level of employer contribution which then, in turn, affects the resources available for the Council's priorities

Section 3 - Statutory Officer Clearance

Name Dawn Calvert



Director of Finance

Date: 25 February 2016

Ward Councillors notified:

NO

Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager
0208 424 1450

Background Papers - None

Review of Internal Controls at Fund Managers

Aviva Investors

“Report on Internal Controls” for the period 1 October 2014 to 30 September 2015.

Auditors: PricewaterhouseCoopers LLP

In the auditor’s opinion, in all material respects:

- a) the description in sections D to G fairly presents the investment management services that were designed and implemented throughout the period from 1 October 2014 to 30 September 2015;
- b) the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls operated effectively throughout the period from 1 October 2014 to 30 September 2015 and customers applied the complementary customer controls referred to in the scope paragraph of this report;
- c) the controls tested, which together with the complementary customer controls referred to in the scope paragraph of this report, if operating effectively, were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period from 1 October 2014 to 30 September 2015.

Of the 171 controls tested by the auditor, 8 exceptions were identified.

These exceptions and the management responses are included at the end of this appendix.

BlackRock Inc

“Report on Controls at BlackRock Placed in Operation and Tests of Operating Effectiveness for Asset Management Services” for the period 1 October, 2014 to 30 September, 2015.

Auditors: Deloitte and Touche LLP

In the auditor’s opinion, in all material respects:

- a.) the description fairly presents the System that was designed and implemented throughout the period 1 October, 2014 to 30 September, 2015;
- b.) the controls related to the control objectives stated in the Description of the System were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the period 1 October, 2014 to 30 September, 2015, and user entities applied the complementary user entity controls contemplated in the design of BlackRock’s controls throughout the period 1 October, 2014 to 30 September, 2015;
- c.) the controls tested, which together with the complementary user entity controls referred to in the scope paragraph of this report, if operating effectively, were those necessary to provide reasonable assurance that the control objectives stated in the Description of the System were achieved, operated effectively throughout the period 1 October, 2014 to 30 September, 2015.

Of the 137 controls tested by the auditor, 4 exceptions were identified:

- 1.) **Page 76 – Control D.1.8** – For 1 of 45 wire instructions selected for testing, performance of the dual authorisation was unable to be evidenced. Additionally, noted that the unique bank-approved stamps remain unlocked on a dedicated senior manager’s desk when not in use during office hours for the Tokyo, Japan location.

Management Response: Due to the use of unique bank-approved stamps, Japanese trust banks do not require dual authorisation to process wire payments, but management requires dual authorisation for all manual payments globally. While dual authorisation could not be evidenced for one margin payment in a sample, management was able to confirm that the payment was appropriate. In February 2015, BlackRock and the Japanese trust banks implemented a new payment process whereby settlement instructions for individual margin movements are no longer required.

- 2.) **Page 79 – F.1.4** – For 1 of 25 securities selected for testing from the Unreviewed Securities Held in Positions Report, DIG was unable to provide evidence of research and monitoring.

Management Response: Management confirmed that the modification made was authorised, however, evidence of continuous monitoring prior to resolution was not able to be provided for testing. The modified security was reviewed within eighteen business days. Management noted that the exception identified had no impact to BlackRock-managed client accounts.

- 3.) **Page 91 – L.1.1** – For 1 of 50 client reports selected for testing, performance of the quality assurance review was unable to be evidenced.

Management Response: Management confirmed that the relevant teams were notified that the Australian fund-specific report was available for quality assurance review, however, no evidence of review was available for testing. Client Reporting Management re-emphasised the importance of maintaining the evidence of completed reviews. Additionally, Aladdin Client Reporting, a centralised deliverable management tool that captures evidence of approval as a key element of the overall production process, has been implemented in Australia for client-specific deliverables.

- 4.) **Page 102 – Q.1.3** – For 2 of 102 individuals across new hires, transfers, and terminations selected for testing to identify timely notification by HR to corporate groups, noted that HR-act transfer notifications were not sent timely. New access was not granted until notifications were received.

Management Response: HR Management re-emphasised the importance of the quality and timeliness of HR notifications as well as the retention of applicable documentation to the teams responsible for processing personnel updates in the HR system of record. HR is reviewing the timeliness of transfer notifications and processing through key metrics and process review.

GMO

“Report On GMO’s Description of its Advisory Services System and on the Suitability of the Design and Operating Effectiveness of Controls” for the period October 6, 2014 to September 30, 2015

Auditors: PricewaterhouseCoopers LLP

In the auditor’s opinion, in all material respects:

- a.) the description fairly presents the Advisory Services System that was designed and implemented throughout the period October 6 2014 to September 30 2015;
- b.) the controls related to the control objectives of GMO stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the period October 6 2014 to September 30 2015 and user entities applied the complementary user entity controls contemplated in the design of GMO’s controls throughout the period October 6 2014 to September 30 2015;
- c.) the controls of GMO tested, which together with the complementary user entity controls referred to in the scope section of this report, if operating effectively, were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period October 6 2014 to September 30 2015.

Of the 159 controls tested by the auditor, 2 exceptions were identified:

- 1) **Page 55 – Control 1d** – For 1 of 5 samples selected for testing, the review of updated client account information from the unit registry was not performed for an Australian account in a timely manner.

Management Response: Management acknowledges the finding. GMO has implemented process changes which are designed to ensure that more timely reviews are carried out going forward.

- 2) **Page 59 – Control 2b** – For 1 of 30 samples selected for testing, a change request for a US and UK account was not sent to the transfer agent in a timely manner.

Management Response: Management acknowledges the finding. The communication of this specific type of change is done manually. Management is considering putting in place additional measures that could prevent reoccurrence of this issue.

Insight Investment

“Statement of Internal Controls Over Investment Management Services for the Year Ended 31 December 2014”

Auditors: KPMG LLP

In the Auditor’s opinion, in all material respects:

- d.) the description on pages 10 to 55 fairly presents the investment management activities that were designed and implemented throughout the period 1 January 2014 to 31 December 2014;
- e.) the controls related to the control objectives stated in the description on pages 10 to 55 were suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls operated effectively throughout the period from 1 January 2014 to 31 December 2014; and
- f.) the controls that we tested were operating with sufficient effectiveness to provide reasonable assurance that the related control objectives stated in the description were achieved throughout the period 1 January 2014 to 31 December 2014.

Of the 133 controls tested by the auditor, 5 exceptions (of which 3 appear to relate to the same issue) were identified:

1. KPMG also inspected the [currency risk management] set up schedule to determine whether the schedule had been signed off by Research and Currency Application Support Team to verify the accuracy and completeness of the restrictions coded.

Exception noted; For 1 out of the 2 clients selected, it was noted that the signed account set up schedule had not been retained.

Management response: The missing Account Set-up Schedule above refers to an existing account transition. All investment management activities were handled correctly. However, the CPM Team failed to follow the procedure of filing a paper based Account Set-up Schedule. The remedial action was to remind members of the CPM Team to follow the established procedure.

2. For a selection of new [Currency Risk Management] accounts inspected the account set-up schedule to determine whether the schedule had been signed off by Research and Currency Application Support Team to verify the accuracy and completeness of the restrictions coded.

Exception noted; For 1 out of the 2 clients selected, it was noted that the signed account set up schedule had not been retained.

Management response: The missing Account Set-up Schedule above refers to an existing account transition. All investment management activities were handled correctly. However, the CPM Team failed to follow the procedure of filing a paper based Account Set-up Schedule. The remedial action was to remind members of the CPM Team to follow the established procedure.

3. For a selection of weeks, inspected meeting minutes for the Investment Management Team meetings to determine whether the minutes included discussion of strategy and portfolio construction.

Exception noted: For 1 out of 5 weeks selected it was noted that the meeting minutes had not been retained.

Management response: The meeting referred to above is the Global Government meeting. The meeting was held as scheduled, however due to an administrative error, a copy of the minutes could not be located on file. The remedial action was to remind the meeting Secretary of the established procedure to retain meeting minutes.

4. For a selection of client payment instructions, inspected the signed client instructions and relevant authorised signatory list to determine whether the client instructions had been validated by the CS team.

KPMG also inspected the cash flow posting to determine whether the instruction had been input completely and accurately and it had been input and authorised by two members of the payments team.

Exception noted: For 10 out of 40 client instructed payments selected Insight were unable to produce the original signed client instruction.

Management response: The cash payments process was insourced from Northern Trust in August 2012. This resulted in a number of legacy regular payments moving from NT to Insight.

A subsequent review of the process highlighted the fact that the original client instructions when each payment was established had not been retained by NT. This is not in line with Insight's current procedures.

At this point Insight assessed the risk profile of each client (and payment) for which there was no original authorisation on file. This was performed using the criteria for simplified due diligence. Each client and payment was concluded to be low risk and therefore a decision was made to re-seek the client instructions for filing at the next client review date. Low risk clients are on a 3 year cycle and therefore these original client instructions will not be on file until late 2015.

5. For a selection of new [Currency Risk Management] accounts inspected the account set-up schedule to determine whether the schedule had been signed off by Research and Currency Application Support Team to verify the accuracy and completeness of the restrictions coded.

Exception noted; For 1 out of the 2 clients selected, it was noted that the signed account set up schedule had not been retained.

Management response: The missing Account Set-up Schedule above refers to an existing account transition. All investment management activities were handled correctly. However, the CPM Team failed to follow the procedure of filing a paper based Account Set-up Schedule. The remedial action was to remind members of the CPM Team to follow the established procedure.

Longview Partners LLP

“Assurance Report on Internal Controls” for the period 1 January 2014 to 31 December 2014.

Auditors: Moore Stephens LLP

In the Auditor’s opinion, in all material respects:

- a) the accompanying report by members describes fairly the control procedures that relate to the control objectives referred to above which were in place as at 31 December 2014;
- b) the control procedures described in section 6 were suitably designed such that there is reasonable, but not absolute, assurance that the specified control objectives would have been achieved if the described control procedures were complied with satisfactorily; and
- c) the control procedures that were tested, as set out in the attachment to this report were operating with sufficient effectiveness for us to obtain reasonable, but not absolute, assurance that the related control objectives were achieved in the period 1 January 2014 to 31 December 2014.

Of the 92 controls tested by the auditor, 0 exceptions were identified

Oldfield Partners LLP

“AAF 01/06 Assurance Report on Internal Controls” for the period 1 July 2014 to 30 June 2015

Auditors: Deloitte LLP

In the auditor’s opinion, in all material respects:

- a.) the description on pages 10 to 37 fairly presents the control procedures of Oldfield Partners LLP’s investment management services that were designed and implemented throughout the period 1 July 2014 to 30 June 2015;
- b.) the controls related to the control objectives stated in the description on pages 10 to 37 were suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls operated effectively throughout the period 1 July 2014 to 30 June 2015; and
- c.) the controls that we tested were operating with sufficient effectiveness to provide reasonable assurance, that the related control objectives stated in the description were achieved throughout the period 1 July 2014 to 30 June 2015.

Of the 153 controls tested by the auditor, 0 exceptions were identified.

Pantheon

“Type II Report on Controls Placed in Operation Relating to Investment Advisory and Management Activities” for the period from 1 October, 2014 to 30 September, 2015

Auditors: KPMG LLP

In the auditor’s opinion, in all material respects:

- a.) the Description fairly presents the Investment Advisory and Management Activities system as designed and implemented throughout the period from 1 October 2014 to 30 September 2015;
- b.) the controls related to the control objectives stated in the Description were suitably designed throughout the period from 1 October 2014 to 30 September 2015; and
- c.) the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the Description were achieved, operated effectively throughout the period from 1 October 2014 to 30 September 2015.

Of the 107 control objectives tested by the auditor, 0 exceptions were identified:

Record Currency Management Ltd

“Report on Internal Controls (AAF 01/06)” for the period 1 April, 2014 to 31 March, 2015.

Auditors: Grant Thornton UK LLP

The auditors confirmed that:

- a.) the report describes fairly the control procedures that relate to the control objectives referred to above which were in place as at 31 March 2015;
- b.) the control procedures described are suitably designed such that there is reasonable assurance that the specified control objectives would be achieved if the described control procedures were complied with satisfactorily; and
- c.) the control procedures described were operating with sufficient effectiveness to provide reasonable assurance that the related control objective were achieved during the specified period.

Of the 137 controls tested by the auditor, 0 exceptions were identified.

Standard Life Investments

“Internal Controls Report” for 1 October 2014 to 30 September 2015

Auditors: PricewaterhouseCoopers LLP

In the Auditor’s opinion, in all material respects:

- (a) the description on pages 24 to 119 fairly presents the in-scope investment management services that were designed and implemented throughout the period from 1 October 2014 to 30 September 2015;
- (b) the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls operated effectively throughout the period from 1 October 2014 to 30 September 2015 and clients applied the complementary client controls referred to in the scope paragraph of this report;

- (c) the controls tested, which together with the complementary client controls referred to in the scope paragraph of this report, if operating effectively, were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period from 1 October 2014 to 30 September 2015.

Of the 334 controls tested by the auditor, 7 exceptions were identified:

These exceptions and the management responses are included at the end of this appendix.

State Street Global Advisors

“Service Organisation Control Report” July 1, 2014 – June 30, 2015

Auditors: Ernst & Young LLP

In the auditor’s opinion, in all material respects:

- a.) the Description fairly presents SSGA’s Investment Advisory System Applicable to the Processing of Client Transactions that was designed and implemented throughout the period July 1, 2014 to June 30, 2015;
- b.) the controls related to the control objectives stated in the Description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the period July 1, 2014 to June 30, 2015 and if user entities applied the complementary user entity controls contemplated in the design of SSGA’s controls and if State Street’s Information Technology and Global Security divisions applied the controls contemplated in the design of State Street’s controls throughout the period July 1, 2014 to June 30, 2015;
- c.) the controls of SSGA tested, which, together with the complementary user entity controls and States Street’s Information Technology and Global Security divisions’ controls referred to in the scope paragraph of this report if operating effectively, were those necessary to provide reasonable assurance that the control objectives stated in the Description were achieved, operated effectively throughout the period July 1, 2014 to June 30, 2015.

Of the 165 controls tested by the auditor, 4 exceptions were identified:

- 1.) **Control 2.1** – Out of a combined sample of 87 new or amended funds/accounts selected for testing, we identified the following deviations in the UK:
 - For 1 out of 25 new or amended fund/accounts selected for testing, a checklist was not completed

- For 2 out of 25 new or amended fund/accounts selected for testing, the checklist was not reviewed by a second person

Management Response: Management acknowledges that for 1 out of 25 new or amended fund/accounts selected for testing in the UK, a checklist was not completed. Management also acknowledges that for 2 out of 25 new or amended fund/accounts selected for testing in the UK, the checklist was not reviewed by a second person. Management confirmed that the new or amended funds/accounts procedures were performed accurately and timely based on the contract/agreement. Management has reinforced with the appropriate personnel the requirement to maintain proper documentation of review.

2.) **Control 12.1** – Accounts set up as Investment Programs or Mandates in CRS in the US:

- For all 3 accounts selected for testing during the period July 1 2014 to March 31 2015 the client reporting package did not include the new account. Management determined that all accounts set up in the US as Investment Programs or Mandates during the period July 1 2014 to March 31 2015 were not included on the respective client reporting package.
- No deviations were noted for accounts set up as Investment Programs or Mandates in CRS during the period April 1 2015 to June 30 2015.

Management Response: Management acknowledges that for the 3 accounts tested, the new account was not included in the client reporting package. Management determined that due to a transition of responsibility in setting up new accounts, certain manual steps were not completed for accounts set up as Investment Programs or Mandates and therefore were excluded from being captured in the client reporting package. Management performed a full analysis of the July 2014 through March 2015 time periods and found that 60 new accounts set up as Investment Programs or Mandates out of 601 total new accounts were omitted from the pdf version of their respective performance report and were therefore not included in the client reporting package. This affected 13 out of 189 clients that had changes and 53 reports out of 13,513 that were distributed during this time. Refer to Section V “Client Reporting” for additional information on the availability of client reports and information on ssga.com. Effective April 1 2015, Management has implemented an additional step within the change management process of identifying client package configuration levels of Client, Investment Program and Mandate in the New/Closed Account report. Management has reinforced with appropriate personnel the applicable change management process that needs to be followed for all client report changes.

- 3.) **Control 13.6** – For 2 out of 2 monthly RMS generated listings of approved invoices selected for testing, it was noted that the invoice listings and exceptions were not reviewed timely.

Management Response: Management acknowledges that for 2 out of 2 monthly RMS generated listings of approved invoices selected for testing, it was noted that the invoice listings and exceptions were not reviewed timely. Management confirms that all invoices on the 2 monthly RMS generated listings of approved invoices were prepared and reviewed by separate individuals. Management has reinforced the requirement to perform timely review of the RMS generated listing of approved invoices.

- 4.) **Control 13.7** – For 2 out of 2 monthly reconciliations of client prepared invoices to RMS fee calculations selected for testing it was noted that the review of the reconciliations was not performed timely.

Management Response: Management acknowledges that for 2 out of 2 monthly reconciliations of client prepared invoices to RMS fee calculations selected for testing were not reviewed timely. Management confirms that variances were researched as appropriate. Management has reinforced the requirement to perform timely review of the fee payment reconciliation.

Table showing number of controls tested by each manager and the number of exceptions as reported to Committee in 2014, 2015 and 2016

Fund Manager	Control Objectives Tested 2014 Report	Number of Exceptions 2014 Report	Control Objectives Tested 2015 Report	Number of Exceptions 2015 Report	Control Objectives Tested 2016 Report	Number of Exceptions 2016 Report
Aviva	158	5	177	7	171	8
BlackRock	182	5	138	2	137	4
GMO	N/A	N/A	200	1	159	2
Insight	N/A	N/A	133	5	133	5
Longview	101	0	92	0	92	0
Oldfield Partners LLP	N/A	N/A	149	3	153	0
Pantheon	97	1	103	1	107	0
Record	137	3	138	0	137	0
Standard Life	213	4	232	4	334	7
State Street	159	5	156	3	165	4

SECTION H: MANAGEMENT RESPONSES TO EXCEPTIONS NOTED

Control Reference	Control Description	Test of Control Procedures and exceptions noted
1.2.1.2	The Derivatives Officer approves the use of new derivative instruments in accordance with the Derivatives Policy, prior to entering into a derivatives transaction for the first time	<p>Reliance on Controls Assurance team For a sample of new instruments, inspected the email confirmations for evidence that the Derivatives Officer approved the new derivative usage prior to entering into the transaction for the first time.</p> <p>Exception noted For all three of the new derivative instruments traded since 1st October 2014, approval from the Derivatives Officer was not obtained.</p>
Management response		
The Derivatives approval process has been reviewed and communicated to the business. The updated procedure has been circulated within the Derivatives Operations team and has also been discussed on the desk and in team meetings and its importance has been reinforced. A log of new instruments showing key information and the progress of approvals has been implemented. Team members have been allocated primary and secondary responsibility for obtaining approval responses and collating these on the log.		
1.2.2.5	Review of compliance order allocation variation reports that highlight any deviations from the original Aladdin algorithm.	<p>For a sample of days, inspected the compliance order allocation variation report for evidence of the review by Head of Dealing</p> <p>Exception noted For 10 out of 40 samples selected, no evidence of review could be provided</p>
Management response		
The missing documentation occurred as a consequence of reports being accidentally overwritten. Reports are now saved with unique names which clearly distinguish between fixed income and equity trades. In addition to the control referred to, the Heads of Rates and Equities, who report into the Head of Dealing, carry out a check of compliance post-trade order allocation variation reports that highlight any deviations from the original Aladdin algorithm on a daily basis.		
1.2.2.13	Review of a weekly Aladdin report detailing FX trades both raised in Aladdin and executed by FX dealers, to ensure such trades were executed based on instructions received	<p>For a sample of weeks after 1 December 2014, inspected the sign-off sheets for evidence that the FX trades both raised in Aladdin and executed by FX dealers were reviewed by the Dealing Manager</p> <p>Exception noted For two out of 15 samples selected, the review was not performed in a timely manner</p>
Management response		
The control was not performed on a timely basis as a consequence of holiday absence. Designation of delegates in cases of absence is now in place.		
1.5.1.6	Where a rule or restriction cannot be monitored independently by Mandate Monitoring, the Mandate Monitoring team obtains confirmations from fund managers to self-certify that they are in compliance with the relevant investment guideline restriction, using a checklist to ensure all such self-certifications are obtained timely	<p>For a sample of self-certified guidelines and periods, inspected the self-certification checklists or emails for evidence that self-certifications were performed in a timely manner</p> <p>Exception noted For one out of 45 samples selected, self-certification was not performed in a timely manner</p>
Management response		
Although an isolated instance, which has been fully remediated, a review of the entire Centralised Rule Repository population will be carried out to ensure all self-certifications have been captured, and can be performed and evidenced in a timely manner.		
2.2.1.3	Capital expenditure proposals prepared by the Asset Manager are reviewed by the Fund Manager/Sector Head/ITC (in accordance with Delegated Authority Schedule) to ensure they are in accordance with investment guidelines and acceptable risk criteria as set out in the fund documentation/client IMA	<p>For capital expenditure proposals, reviewed the evidence that these were approved in line with the Delegated Authority Form</p> <p>Exception noted For eight out of 50 capital expenditures, approval in line with the Delegated Authority Schedule was not obtained prior to the expenditure being incurred</p>
Management response		
50 items were tested which represented 100% of the population. For the eight instances where insufficient authority had been obtained, these have been approved retrospectively in accordance with the Delegated Authority Schedule. The Transaction Authority forms (TAFs) will be standardised for all asset managers with the delegated authority limits embedded within the TAFs which will ensure that the expenditure levels and related signature requirements are much clearer to the user of the form than has been the case previously.		

SECTION H: MANAGEMENT RESPONSES TO EXCEPTIONS NOTED (CONTINUED)

Control Reference	Control Description	Test of Control Procedures and exceptions noted
3.1.1.3	<p>Access to Aviva Investors offices - Access removal</p> <p>The Property and Facilities team receive notification of leavers via the Teamworks tool. On receipt of a leaver's request, the Property and Facilities team set the individual's physical access card to disable on the specified leave date.</p>	<p>For a sample of leavers in the period, inspected evidence that each individual's physical access card had been disabled on the specified leave date.</p> <p>Exception noted</p> <p>For two out of 244 leavers, access cards to the Aviva Investors offices were not disabled on the specified leave date.</p>
<p>Management response</p> <p>After further investigation, it was confirmed that the two identified leavers had not used their access cards after their leave date. Upon identification, the identified leavers' cards were subsequently disabled. A weekly control has been introduced to review the leavers in the week, and ensure all passes have been disabled accordingly.</p>		
3.1.2.3	<p>HR raises leaver requests for permanent, fixed term contract and temporary staff within Teamworks. IT Security Administration is notified of the leaver request via an automated email and set the Windows AD account to expire on the specified leave date. Depending on the authentication mechanism in place for each application, either IT Security Administration or the application support team then revoke application access. Note: For the Aladdin application third party BRS remove the application account on receipt of an approved request from IT Security Administration.</p>	<p>Inspected evidence that access to the Windows AD network, in scope applications and underlying databases had been revoked in a timely manner for all leavers in the period.</p> <p>Exception noted</p> <p>For three out of the full population of 244 leavers during the period under review, Blackrock was not sent an approved removal request by the IT Security Administration team and so the user accounts remained active on the Aladdin application after their leave dates.</p>
<p>Management response</p> <p>The three leavers had limited access to the system and represented less than 2% of the total population. Subsequent review confirmed that the three accounts in question were not accessed after their leave date and have been subsequently disabled. After 60 days of inactivity BRS will also disable active Aladdin accounts. A monthly detective control has been introduced to review and remove any Windows accounts not active for over 90 days, plus associated downstream systems.</p>		
3.4.3.2	<p>BCM</p> <p>The BCM team facilitates the testing of critical activities in business continuity plans annually. Any issues identified are logged on an actions register which is managed and maintained by the respective Business Unit Risk Manager.</p> <p>ITDR</p> <p>The application support team, with assistance from the IT Service Continuity (ITSCM) team, test critical activities as defined in the Configuration Management Database (CMDB) and their respective IT service continuity and application recovery plans annually. Any issues identified are logged on an actions register which is managed and maintained by the respective application support manager.</p>	<p>BCM</p> <p>Inspected evidence that Business Continuity Plans had been tested by the BCM team in the period and that issues identified during the testing had been logged on an actions register maintained by the respective Business Unit Risk Manager.</p> <p>ITDR</p> <p>Inspected evidence that critical activities defined in the CMDB and their respective IT Service Continuity/Application Recovery Plans had been tested in the period, and that any issues identified had been logged on an actions register for investigation by the respective application support team.</p> <p>Exception noted</p> <p>For the Advantage application, no Disaster Recovery fail-over test was performed during period under review.</p>
<p>Management response</p> <p>The Disaster Recovery tests were deferred to allow for completion of server operating system and hardware refresh. Whilst the majority of the Disaster Recovery tests were completed by 30 September 2015, the Disaster Recovery test for the Advantage application will be conducted on 28 November 2015. The most recent test for Advantage was completed on 7 June 2014.</p>		

Other information provided by Standard Life Investments

The Service Auditor's tests have identified seven exceptions. Responses from management in respect of exceptions noted by the Service Auditor in performing testing of Standard Life Investments Limited's controls are presented below to provide additional information to users of this report.

Management Responses to Exceptions Noted

Information Technology - SLI

1. Standard Life Investments Descriptions of Controls	Service Auditor's Tests specific to the exceptions noted
<p>2.10 - Users' permission level access for CRIMS is reviewed for appropriateness on an annual basis by heads of desk or line managers. Any inappropriate access is removed on a timely basis.</p>	<p>Inspection For a sample of CRIMS users, inspected evidence that the user's permission level access was reviewed for appropriateness by their head of desk or line manager and that any inappropriate access has been removed on a timely basis.</p> <p>Exception Noted: For two of 29 items tested, no response was received from the users' line managers and the users' CRIMS permissions level access was therefore not recertified.</p>
Management response	
<p>Management can confirm that recertification has since been performed for the two users. Management can also confirm that these users were not part of Front Office and as such do not have dealing authority. Management are confident that all Front Office users with elevated permissions have been recertified.</p> <p>Management will ensure a review of the permission level recertification process for CRIMS is carried out ahead of the next recertification in Q1 2016, with a view to implementing improvements to streamline the process:</p> <ul style="list-style-type: none"> ➤ Change approval lines to Line Managers instead of Heads of Desk; ➤ Creation of a recertification tool, which will reduce the dependency of manual intervention, reducing the likelihood of errors; ➤ Produce an updated report for managers, providing them with a clearer understanding of the access levels for each user contained within CRIMS; and ➤ Introduce a four eye check on the completed recertification. 	

(Information Technology SLI continued)

2. Standard Life Investments Descriptions of Controls	Service Auditor's Tests specific to the exceptions noted
<p>9.2. Oversight of incident and problem resolution is performed by the Global Incident Response Team (GIRT). Key information including call answering SLAs, incident fix times against target, problem volumes, VIP Incidents, Knowledge Base and Customer Satisfaction Questionnaires is reviewed.</p> <p>Until May 2015, this was performed via weekly service manager meetings and monthly senior service manager meetings.</p> <p>From June 2015, this was performed via monthly service manager meetings and quarterly senior service manager meetings.</p>	<p>For the period to May 2015:</p> <p>Inspections For a sample of weeks, inspected evidence of the review of incidents and problem resolution as part of the weekly service managers meetings.</p> <p>For a sample of months, inspected evidence of the review of incidents and problem resolution as part of the weekly senior service managers meetings.</p> <p>For the period from June 2015:</p> <p>Inspections For a sample of months, inspected evidence of the review of incidents and problem resolution as part of the weekly service managers meetings.</p> <p>For a sample of quarters, inspected evidence of the review of incidents and problem resolution as part of the weekly senior service managers meetings.</p> <p>Exception Noted: Prior to the change of control frequency, for one of the 7 weekly meetings tested, the meeting did not occur, without an appropriate explanation for cancellation.</p>
Management response	
<p>Following changes to the control frequency, management can confirm that all monthly service manager meetings and all quarterly senior service manager meetings have taken place and have been well attended.</p> <p>Management will ensure any meetings that do not take place in future on the intended dates, will be rescheduled as opposed to being cancelled. Any poor attendance will be escalated via the Senior Management team at the Quarterly Governance Board meeting.</p>	

Information Technology - hignis

3. Standard Life Investments Descriptions of Controls	Service Auditor's Tests specific to the exceptions noted
<p>2.4. Users' account level access to the network and key applications is recertified on at least annual basis by their line manager. Any inappropriate access is removed on a timely basis.</p>	<p>Inspections Inspected evidence that the user access recertification at the account level had been undertaken during the period.</p> <p>For a sample of users, inspected evidence that the appropriateness of users' network and application level access had been reviewed by their line manager, with any inappropriate access being removed on a timely basis.</p> <p>Exception Noted: Our review of the Q4 account level access recertification noted that no response was obtained from the users' line managers for the 178 SLI users included within the recertification and the users' account level access was therefore not recertified.</p>
<p>Management response</p>	
<p>Management will ensure a full recertification of all Standard Life Investments staff with access to hignis platforms takes place post the completion of Thinkfolio's lift and shift into Standard Life Investments environment.</p>	

Real Estate Management - UK and European Funds

4. Standard Life Investments Descriptions of Controls	Service Auditor's Tests specific to the exceptions noted
<p>2.1. Prior to any purchase, sale or development being approved, a detailed budget is prepared by the portfolio, fund or development manager in a DD1 form. The DD1 is attached to the approval memo and approved in line with the levels of approval set out in the Authorities document.</p> <p>The System Administration team input the data from the DD1 into the Capital Expenditure (CapEx) System with entry by junior personnel undergoing secondary review for accuracy.</p>	<p>Inspections For a sample of purchases, sales and developments during the period, inspected evidence that a detailed budget was prepared by the Portfolio Manager in the DD1 and that the DD1 was approved in line with the Authorities document prior to processing.</p> <p>For the same sample, inspected evidence of secondary review for accuracy of the information input from the DD1 into the CapEx system.</p> <p>Exception Noted: For one of 13 items tested, the DD1 form was not approved in line with the levels of approval set out in the Authorities document.</p>
<p>Management response</p>	
<p>'Management will ensure that DD1 forms are checked by the Fund Manager and Investment Director before the form is passed to the Account Department.</p> <p>Management will ensure that they will perform a review over the governance and authorisation process of DD1 forms, with a view to removing the need for the Head of Real Estate to sign DD1 forms, as their approval on Approval Memo's should be sufficient oversight and governance over the process.</p>	

(Real Estate Management - UK and European Funds continued)

5. Standard Life Investments Descriptions of Controls	Service Auditor's Tests specific to the exceptions noted
<p>6.1. The System Administration team update the Property Management System data on a timely basis for properties purchased and sold. Updates are reviewed for accuracy by another System Administration team member.</p>	<p>Inspection For a sample of updates to the property management system, inspected evidence of timely entry and review of accuracy by a second member of the System Administration team.</p> <p>Exception Noted: For three of 12 items tested, the Property Management System was not updated on a timely basis, timely being one week after the instruction was received.</p>
<p>Management response</p>	
<p>Management can confirm that the DD1 approval process should be completed within a 7 working day timeline. Management will ensure a communication is issued to all members of the Real Estate front office and Systems Administration teams, to confirm that the Real Estate front office team should provide signed DD1 documents to the Systems Administration team within 24 hours of authorisation, to allow the Systems Administration team time to update the Property Management System (Horizon) within the 7 working day timeline.</p> <p>To help facilitate meeting the 7 working day timeline, management will ensure that the Systems Administration team create an electronic workflow to move this process from a paper based one to electronic sign off.</p>	

Real Estate Management - UK Funds only

6. Standard Life Investments Descriptions of Controls	Service Auditor's Tests specific to the exceptions noted
<p>14.3. On a monthly basis, the Real Estate Operations team produce the Fund Constraints reports for each fund and pass these to Fund Managers on a timely basis for review and feedback on any breaches.</p> <p>NB. Ignis Funds only</p>	<p>Inspection For a sample of funds and months, inspected evidence that the Funds Constraints report was produced and passed to Fund Managers on a timely basis and, where breaches were noted, feedback was provided on breaches.</p> <p>Exception Noted: For all of the 9 items tested, the fund constraints reports were prepared, however these were not sent for review in a timely manner, timely being within two weeks after month end.</p>
<p>Management response</p>	
<p>Management can confirm that none of the funds within the 9 Fund Constraints reports sampled, were in breach. Treasury and pricings items are monitored daily and any impending breaches are picked up on the day in question from this process and do not rely on the risk limit reports being produced.</p> <p>Management will ensure that all future fund constraints reports (for the 3 Ignis funds) are issued in a timely manner each month, being within 2 weeks of month end. Emails circulating the reports will be saved down and retained on our documents management system (eDocs).</p>	

Real Estate Management - European Funds only

7. Standard Life Investments Descriptions of Controls	Service Auditor's Tests specific to the exceptions noted
<p>6.2. Portfolio managers ensure that title deeds are lodged/retained with an appropriate third party at the point of purchase, such as property managers and lawyers, depending on the local market and country conventions. A checklist is completed and signed-off to evidence that properties purchased are of marketable title and that documents have been lodged with the appropriate third party for safe-keeping.</p>	<p>Inspection For a sample of purchases, inspected pre-exchange checklists to confirm that documents were lodged with an appropriate third party.</p> <p>Exception Noted: For three of the 7 items tested, there was no sign-off to evidence that the documents were lodged with the appropriate third party for safe-keeping.</p>
<p>Management response</p>	
<p>Management can confirm that the title deeds relating to the items tested have been retained for safekeeping by a relevant third party for the jurisdictions concerned.</p> <ol style="list-style-type: none"> 1. Management will ensure they arrange for written confirmation from the relevant third parties, that the title documents are being held securely and safeguarded from loss, misappropriation and unauthorised use. 2. Management will ensure a reminder is issued to all fund managers, portfolio managers and investment directors, of the importance of using the correct checklist and to ensure that the checklist records where the title documents are held for safekeeping. 	

**REPORT FOR: PENSION FUND
COMMITTEE**

Date of Meeting:	9 March 2016
Subject:	Information Report – Environmental, Social and Governance Issues in Pension Fund Investment
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	Appendix 1 – UN PRI and UK Stewardship Code Appendix 2 – Submissions received from Fund Managers.

Section 1 – Summary

The report sets out the responses received to requests made to the Fund managers in relation to the Committee's consideration at their last meeting of the Environmental, Social and Governance Issues.

FOR INFORMATION

Section 2 – Report

1. At their meeting on 25 November 2015 the Committee received a report discussing Environmental, Social and Governance Issues and Pension Fund Investment and resolved that:

(1) investment managers and Aon Hewitt, Council’s Investment Adviser, be asked to advise whether they had signed up to UN Principles for Responsible Investment (PRI);

(2) investment managers and Aon Hewitt, Council’s Investment Adviser, be asked to confirm that they had signed up to “The UK Stewardship Code” and to provide reports on their engagement and voting actions;

(3) in the light of the responses received to resolutions (1) and (2) above, the Fund consider further whether to sign up to “The UK Stewardship Code” in its own right following the receipt of a further report setting out any conditions in relation to appendix 3 of the report and concerns about creating an infrastructure dependent on resolutions (1) and (2) above;

(4) the Fund take a more active involvement in the Local Authority Pension Fund Forum by attending meetings at a Member or officer level and by more specifically associating itself with various initiatives;

(5) within the Statement of Investment Principles the current paragraph on “social, environmental or ethical considerations” be amended in accordance with paragraph 27 of the report and those made at the meeting, as follows:

“The Council recognises that it has a paramount duty to seek to obtain the best possible return on the Fund’s investments taking into account a properly considered level of risk. As a general principle it considers that the long-term financial performance of a country/asset in which it invests is likely to be enhanced if good practice is followed in environmental, social and governance activities.

All the Fund’s investments are managed by external fund managers mostly within pooled funds. Currently, one is passively managed and one is specifically invested in emerging markets. The Council recognises the constraints inherent in this policy. Nevertheless it expects its external fund managers, acting in the best financial interests of the Fund, to consider, amongst other factors, the effects of environmental, social and other issues on the performance of countries and assets in which they invest.

The Council expects its external fund managers to have signed up to “The UK Stewardship Code” and to report regularly on their compliance with the Code and other relevant environmental, social and governance principles.”

- (6) the Pension Board be requested to consider the need for admitted bodies to be involved in consideration of the importance of ESG issues and to what extent the views of the beneficiaries and representatives of beneficiaries should be taken into account.
2. This report addresses resolutions (1) and (2) and Appendix 1 details the two sets of principles.
3. All the Fund managers except Record Currency were approached and all have responded with the following results:

Aviva

Aviva have provided a large amount of information regarding 'Responsible Investment' but this largely relates to their equity mandates and not specifically to the Fund's property mandate.

Further discussions with Aviva are to take place but they have stated the following in regard to their Global Real Estate Division

- *ESG is embedded in our direct portfolios and pooled funds (who subscribe to GRESB)*
- *ESG is a key element of our indirect real estate strategy and investment process*

BlackRock

BlackRock have confirmed that they have signed up to the UN PRI and their current position regarding each of the principles within the UK Stewardship code is attached in a 2 page document in appendix 2.

A summary of their position is 'As a fiduciary asset manager, BlackRock's pursuit of good corporate governance stems from our responsibility to protect and enhance the economic value of the companies in which we invest on behalf of our clients. Encouraging the highest standards of board leadership and executive management in these companies is central to achieving that goal. That is why we have created one of the largest Corporate Governance and Responsible Investment (CGRI) teams in the industry to engage with the management of companies in which we invest and help us deliver long-term value to our clients. BlackRock believes it complies with the majority of recommendations of the UK Stewardship Code. We have set out below our approach to the key recommendations and explained our reasons for taking a different approach to that proposed in the Code where relevant'.

GMO

GMO have provided two short documents entitled 'GMO Statement Regarding ESG' and 'GMO UK Ltd Statement of Policy on the Principles of the UK Stewardship Code' which are included within Appendix 2

As regards UN PRI, whilst in their covering email they state they are actively pursuing signing up to these principles, they explain their current stance as follows:

'GMO has carefully reviewed the UNPRI and determined not to sign the Principles at this stage. The main rationale for this decision is that we believe that certain of the Principles would conflict with and/or distract GMO from its primary objective of delivering the best risk-adjusted returns to each of its clients. While ESG issues, as such, are not formally part of our investment objectives, certain elements of our security analysis and investment processes may be consistent with managing ESG issues'

Their views on the Stewardship code are *'As an investment manager employing mainly quantitative techniques in our investment strategies we tend not to participate with the collective engagement of companies'*

Insight

Insight have provided a 74 page document entitled 'Putting Principles Into Practice - Insight's Annual Report on Responsible Investment 2014'

The have stated that *'It confirms that Insight have indeed renewed our commitment to the UN PRI, to which we were a founding signatory, and also the Financial Reporting Council's UK Stewardship Code'*

The report goes into detail as follows:

- Responsible Investment At Insight
- How Insight Meets Its Commitments
- Responsible Investment Activities In 2014
- How Insight Implements Its Responsible Investment Policy
- The Responsibilities Of Investors
- Is Responsible Investment Ethical?
- Social Capital And Responsible Investment
- Managing Environmental Risks In Portfolios

Longview

Longview, in their covering email state *'I can however confirm that Longview Partners is a signatory to the United Nations Principles for Responsible Investment and also fully supports and is committed to the UK Stewardship Code'*

Longview have also confirmed their compliance with the UK Stewardship Code and have provided a detailed report as included in the Appendix 2.

They have also provided a report detailing their engagement meetings with various companies/institutions.

Oldfields

Oldfields have provided three short documents entitled 'Statement of compliance with the UK Stewardship Code,' 'Environmental, Social, Governance Q&A' and 'Proxy voting and engagement report – 2015', the first two of which are included in Appendix 2.

Within these documents and their covering email Oldfields state:

'In the ESG Q&A we explain why we are not currently a signatory to the UNPRI. We are essentially in favour but we don't believe the infrastructure is in place to handle collective engagement. We have spoken with the ABI, the FRC and the UK Investor Forum on this subject, hoping that the necessary protection and processes can be put in place so we can confidently collaborate with other investors and if so, we would become a signatory.'

'We are not currently a UN PRI signatory, as we are not yet comfortable that Principle 5 (working together to enhance effectiveness in implementing the Principles) has the necessary infrastructure and protections we think necessary. We have held numerous conversations with the Financial Reporting Council in the UK on this issue and have made clear our concerns about engaging or collaborating with other managers when it is not clear whether they have long or short positions. However, we have recently joined the Investor Forum, hoping this can provide the platform for the kind of collective efforts the PRI promotes.'

Pantheon

Pantheon have provided a customised response included within Appendix 2. Their answers to the specific questions are as follows:

Pantheon is a signatory of the Principles for Responsible Investment (PRI) and has used these principles as a framework to develop its ESG policy across all its investment activities. Pantheon was also a founding member of the PRI Private Equity Steering Committee and only withdrew in 2014 due to a maximum tenure being exceeded. Pantheon has remained involved in sub-committees and continues to assist the PRI with logistics and speakers at conferences.

Although Pantheon has not yet signed up to the UK Stewardship Code, the principles contained within the UK Stewardship Code are akin to Pantheon's ongoing active engagement with the managers in which we invest. Effective post-investment care and the maintenance of close relationships are important to maximize the value of Pantheon's fund investments, protect client interests and to evaluate the investment activity within each fund. Our active involvement on Advisory Boards of the funds in which we invest, as well as our policy on voting, is outlined below.

As a PRI signatory, Pantheon has committed to follow a policy of active ownership, requiring us to vote on all matters. In private equity, voting may

take place on any number of governance, legal or investment matters and therefore each voting matter is considered on a case by case basis. For this reason, Pantheon does not have an internal reference guide to cover all voting matters.

Standard Life

In their covering email Standard life advised as follows:

'Standard Life Investments is a signatory to both the UK Stewardship Code and UN Principles for Responsible Investment (UNPRI). Voting activity on all the companies we invest in are all published and updated regularly on the Governance & Stewardship section of our website'

In their 24 page Governance & Stewardship Review 2014 there are detailed sections on engagement and global voting.

State Street

State Street have provided the following link to a large amount of information including their statement on the UK Stewardship Code.

<https://www.ssga.com/eu/gb/pension-investor/en/products-capabilities/capabilities/corporate-governance-and-voting-policy.html>

Their compliance with the Stewardship Code is included within Appendix 2 and the rest of their submission is being reviewed.

Financial Implications

4. Whilst the attitude of Fund managers to ESG issues can have a significant impact on the performance of the Fund there are no financial implications arising from this report.

Risk Management Implications

5. The risks arising from the management and investment of funds are included in the Pension Fund risk register.

Equalities implications

6. There are no direct equalities implications arising from this report.

Council Priorities

7. Investment performance has a direct impact on the financial health of the Pension Fund which directly affects the level of employer contribution which then, in turn, affects the resources available for the Council's priorities.

Section 3 - Statutory Officer Clearance

Name Dawn Calvert Director of Finance

Date: 25 February 2016

Ward Councillors notified: NO

Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager
0208 424 1450

Background Papers - None

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THE UN PRINCIPLES FOR RESPONSIBLE INVESTMENT (PRI)

- We will incorporate ESG issues into investment analysis and decision-making processes
- We will be active owners and incorporate ESG issues into our ownership policies and practices
- We will seek appropriate disclosure on ESG issues by the entities in which we invest
- We will promote acceptance and implementation of the Principles with the investment industry
- We will work together to enhance our effectiveness in implementing the Principles
- We will report on our activities and progress towards implementing the Principles

THE INSTITUTIONAL SHAREHOLDERS COMMITTEE (ISC) CODE ON THE RESPONSIBILITIES OF INSTITUTIONAL INVESTORS (“THE UK STEWARDSHIP CODE”)

- Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities
- Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed
- Institutional investors should monitor their investee companies
- Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities as a method of protecting and enhancing shareholder value
- Institutional investors should be willing to act collectively with other investors where appropriate
- Institutional investors should have a clear policy on voting and disclosure of voting activity
- Institutional investors should report periodically on their stewardship and voting activities

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Statement on compliance with the UK Stewardship Code

March 2014

As a fiduciary asset manager, BlackRock's pursuit of good corporate governance stems from our responsibility to protect and enhance the economic value of the companies in which we invest on behalf of our clients. Encouraging the highest standards of board leadership and executive management in these companies is central to achieving that goal. That is why we have created one of the largest Corporate Governance and Responsible Investment (CGRI) teams in the industry to engage with the management of companies in which we invest and help us deliver long-term value to our clients.

BlackRock believes it complies with the majority of recommendations of the UK Stewardship Code. We have set out below our approach to the key recommendations and explained our reasons for taking a different approach to that proposed in the Code where relevant. Any questions on this statement or BlackRock's approach to stewardship more generally should be addressed to Amra Balic, EMEA Head of CGRI at europecgri@blackrock.com.

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

BlackRock's Global Corporate Governance and Engagement Principles, as well as our market-specific voting guidelines, are published on our website. In these we explain our philosophy on stewardship (including how we monitor and engage with companies), our voting policy, our integrated approach to stewardship matters and how we deal with conflicts of interest. These apply across different asset classes and products as permitted by investment strategies. Although we use a different terminology to that in the Code we address most of its guidance either in the Principles, which are applied internationally, or in our market-specific voting guidelines. These documents are reviewed and updated annually. Our voting is conducted by the CGRI team of 20 specialists who are a central clearinghouse for our global investment teams to ensure we deliver a consistent message to companies. We publish an annual review which summarises our activities, which is also available on our website:

<http://www.blackrock.com/corporate/en-gb/about-us/responsible-investment>

Principle 2: Institutional investors should have a robust policy on managing conflicts of interests in relation to stewardship and this policy should be publicly disclosed.

BlackRock maintains policies and procedures that are designed to prevent undue influence on BlackRock's proxy voting activity that might stem from any relationship between the issuer of a proxy (or any dissident shareholder)

and BlackRock, BlackRock's affiliates, a Fund (or BlackRock's segregated client) or a Fund's (or BlackRock's segregated client's) affiliates. Steps BlackRock has taken to prevent conflicts include, but are not limited to:

- BlackRock has adopted a proxy voting oversight structure whereby the Corporate Governance Committees oversee the voting decisions and other activities of the CGRI team, and particularly its activities with respect to voting in the relevant region of each Corporate Governance Committee's jurisdiction.
- The Corporate Governance Committees have adopted Guidelines for each region, which set forth the firm's views with respect to certain corporate governance and other issues that typically arise in the proxy voting context.
- BlackRock's Global Corporate Governance Committee oversees the Global Head of CGRI, the CGRI team and the Corporate Governance Committees.
- BlackRock maintains a reporting structure that separates the Global Head of CGRI and the CGRI team from employees with sales responsibilities.
- In certain instances, BlackRock may determine to engage an independent fiduciary to vote proxies as a further safeguard to avoid potential conflicts of interest or as otherwise required by applicable law.

In all situations the overriding purpose of our responsible investment policy is to protect and enhance the economic interests of our clients.

Principle 3: Institutional investors should monitor their investee companies.

BlackRock's fundamental equity portfolio managers and the CGRI team monitor and, when appropriate, engage with investee companies. Our approach is explained in our Global Corporate Governance and Engagement Principles and our UK voting guidelines. We believe our practices are in accordance with the guidance in Principle 3 with one exception. Although we might occasionally attend general meetings of investee companies, we do not attend a significant number of AGMs as we believe we serve our clients' interests better by dedicating our time to one-to-one meetings.

In certain situations BlackRock, in particular the CGRI team, is willing to become an insider; however our policy is to ensure that inside information is not communicated to any member of the investment team without our prior agreement. Where BlackRock does become an insider, we will act in accordance with the policies and processes laid out in our Compliance Manual.

Statement on compliance with the UK Stewardship Code

March 2014

Principle 4: Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

In our Global Corporate Governance and Engagement Principles and our voting guidelines we explain when we would undertake more active engagement, namely when we believe this will enhance and/or protect the economic interests of long-term shareholders (notionally our clients). We believe that our approach to engagement is consistent with the intent of the Code although we would note the following areas where our approach differs from its guidelines. As we approach each engagement individually we do not have a prescribed escalation strategy, as suggested by the Code, as we do not see engagement as mechanistic. However, triggers for engagement can include our assessment that there is potential for material economic ramifications for shareholders resulting from a governance concern. Where we are concerned about the strategic direction the company is taking or the performance of management in delivering strategy, we will engage more heavily. Through regular and frank meetings with management, we try as much as possible to raise queries before they become concerns that require intervention. BlackRock is very unlikely to make public statements about our engagements or to call an extraordinary general meeting or propose shareholder resolutions. Our preference is to engage privately as we believe it better serves the long-term interests of our clients to establish relationships, and a reputation, with companies that enhances rather than hinders dialogue.

Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate.

When we believe it is likely to enhance our ability to engage with a company or to achieve the desired outcome, and it is permitted by law and regulation, BlackRock will work with other investors. To that end, BlackRock is an active member of nearly 40 formal groups and initiatives internationally that facilitate communication between shareholders and companies on corporate governance and social, ethical and environmental matters. We will also engage collectively on matters of public policy, when appropriate.

Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.

BlackRock's voting guidelines are published on our website. In our Global Corporate Governance and Engagement Principles we explain our approach to reporting to clients. We disclose our voting publicly each year in a filing with the US Securities and Exchange Commission, which is also posted to our website. Our voting is conducted by the CGRI team. Voting decisions are taken after review of research from a number of global and local proxy advisory firms and the team's own research of company materials, broker research, and other publicly available information. We use an electronic voting platform to execute the vote instructions. In certain markets, we leverage vendors to apply our internal voting policies to filter out routine or non-contentious proposals. This allows us to focus our time on addressing the most pressing governance concerns which are referred to us for decision.

BlackRock does not borrow shares solely for the purpose of exercising voting rights. With respect to our stock lending program, BlackRock pays due regard to the interests of its clients and it is from this perspective that our policy is defined. There is, therefore, no presumption in favour of either continuing to lend securities or recalling on-loan securities to vote. Each situation is analysed based on client agreements and preferences and on the nature of the voting item. We recall our on-loan stock when we consider it to be in our clients' best interests to vote on all of our holdings.

Principle 7: Institutional investors should report periodically on their stewardship and voting activities.

BlackRock publishes an annual review which summarises our stewardship activities, including engagement trends and case studies as well as voting statistics. We disclose our voting publicly each year in a filing with the US Securities and Exchange Commission. The processes relating to our corporate governance activities are audited periodically by BlackRock Internal Audit

This material is for distribution to Professional Clients (as defined by the FCA Rules) and should not be relied upon by any other persons.

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GMO Statement regarding ESG [Environmental, Social and Governance] Principles
As of September 2015

For more than 35 years, GMO has been a premier provider of investment management solutions to our global client base, consisting of some of the most prestigious institutional investors from the ranks of corporate and public defined benefit and defined contribution plans, foundations, endowments and sovereign wealth funds, among others. Our expertise covers a broad spectrum of capital markets, including developed and emerging equities, developed and emerging fixed income, asset allocation, forestry, agriculture and a full complement of absolute return-oriented strategies.

In terms of delivering on our objectives to clients, GMO's various investment teams utilize a number of approaches in seeking to identify attractively-valued assets. We were one of the early innovators in quantitative investing and continue to use systematic disciplines today. In addition, we have a deep pool of talented fundamental investment professionals in our ranks.

GMO's primary objective is to deliver the best risk-adjusted returns for each of the strategies that the firm offers. In executing on that objective we remain focused on delivering superior investment results, always mindful of the fiduciary duty we have to each of our clients.

GMO recognizes that views vary among investors as to the importance and relevance of ESG factors to their investment strategies and we presently manage several client accounts that incorporate ESG-related factors, such as social screens. In such cases, our clients have established separately managed portfolios (subject to our asset-level requirements which may vary for each strategy) and we adhere to the clearly proscribed guidelines and/or objective screening criteria provided by our clients. At this time, GMO is able to provide limited assistance in the design and ongoing maintenance of such screens. Clients should make their own assessment of the potential impact ESG screening could have on risk-adjusted returns.

In what follows, we describe in more detail the extent to which our investment processes are consistent with key ESG-related principles.

Do we consider ESG issues in our investment analysis and decision-making processes?

Delivering the best risk-adjusted returns is our primary objective. We do not incorporate ESG issues as a secondary objective and our current research shows that incorporating ESG factors into our investment processes could not be relied upon to consistently produce excess returns or reduce risk for our clients.

For example, the investment processes for the strategies managed by our equity teams (Emerging Markets Equity, Focused Equity, Global Equity and International Active) rely on our evaluation of companies' published financial information, securities' prices, equity and bond markets, and the overall economy. In order to provide as broad an opportunity set as possible, we try not to constrain the universes to which we apply our stock selection disciplines and thus generally do not incorporate ESG or other potentially restrictive screens. ESG continues to be an area of research, but currently is applied on a portfolio-by-portfolio basis and not embedded in the core of our investment philosophy or process.

In the rare instances where our equity teams formally incorporate ESG considerations into a strategy's investment process, the primary impetus for doing so is a belief that ESG considerations will not negatively impact return prospects. For example, the investment universe for GMO's Resources Strategy, managed by our Focused Equity team, has firms with particularly poor ESG histories. Our research in this narrow universe suggested that screening these companies out would not have a material impact on returns.

Within our core investment processes, there are certain measures of profitability we do evaluate that may correlate with good governance and a sustainable business. For example, many of our equity strategies incorporate an evaluation of a company's "quality," defined by GMO as high and stable levels of profitability and relatively low levels of debt. While not an explicit objective of our quality factor, we have observed over time that there is a correlation between companies that rank high on our quality measure and those that rank high on social and governance criteria. This relationship could, of course, change at any time.

In our fundamental equity strategies managed by the International Active team, we often consider issues that have ESG elements in the normal course of evaluating a company's valuation level and future prospects. ESG elements will be included where we believe they have a significant impact on the expected return or risk of an investment. It is generally the International Active team's belief that good corporate governance will affect a firm's valuation positively, and we prioritize company efficiency and waste minimization, which we believe leads to higher profitability over time. In addition, we believe that companies that collaborate with the communities in which they do business are more likely to be successful in the long run. Beyond this, the team considers social and environmental issues from a risk management perspective and screens companies regarding potentially significant reputational risk issues (including but not limited to social or environmental issues) and will tend to penalize those companies relative to their industry peers in its analysis.

Our fixed income strategy mix contains both traditional (Core Plus, and Global) and specialty (Emerging Debt and asset-backed securities) strategies. None of GMO's fixed income strategy universes has been narrowed based on ESG-related principles, and none of those investment processes has been designed with such principles in mind. Given that the universes from which we select securities and our value-added processes generally relate to sovereign, quasi-sovereign, and asset-backed debt markets, it is unlikely that we will explicitly factor environmental, social or governance factors into our fixed income strategies.

To what extent will we be active owners and incorporate ESG issues into our ownership policies and practices?

As long-term investors, we seek to defend the interests of our clients not only at the time of initial purchase of securities, but also over the full period these securities are held in the portfolios. Therefore, GMO votes on the equity investments it manages in pooled funds and separately managed accounts unless – in the case of separately managed accounts – clients direct otherwise.

In our pooled funds and where separate account clients have delegated proxy voting to us, GMO has engaged Institutional Shareholder Services (ISS) to act as its proxy voting agent. ISS undertakes research, makes voting recommendations and ensures votes are submitted in a timely manner. In the majority of cases, GMO acts in accordance with those recommendations. Full details of GMO’s voting policy, including default positions on matters of corporate governance, are set out in the document entitled “Proxy Voting Policies and Procedures” as of June 25, 2014. A copy of GMO’s Proxy Voting Policy is available upon request or may be found on the SEC’s website, www.sec.gov, as part of GMO Trust’s registration statement. Proxy voting reports are also available upon request. As with the fundamental analysis performed by our International Active investment team, we may incorporate a variety of factors (which may include ESG issues if we determine they are relevant) when deciding to vote proxies in a particular manner.

To what extent will GMO seek appropriate disclosure on ESG issues by the entities in which we invest?

As described in our proxy voting policy, we have been supportive of initiatives that lead firms to disclose all aspects that could materially impact the value of a firm, including – where we consider it relevant – ESG issues. For example, we generally vote in favor of independent board directors if the majority of the current board members are not independent. In terms of our fundamental research, where applicable, our portfolio managers will similarly push/probe firms to disclose all aspects that could materially impact the value of a firm, including – where we consider it relevant – ESG issues.

Why hasn’t GMO signed the UN Principles for Responsible Investing (UN PRI)?

GMO has carefully reviewed the UNPRI and determined not to sign the Principles at this stage. The main rationale for this decision is that we believe that certain of the Principles would conflict with and/or distract GMO from its primary objective of delivering the best risk-adjusted returns to each of its clients. While ESG issues, as such, are not formally part of our investment objectives, certain elements of our security analysis and investment processes may be consistent with managing ESG issues (as described above).

GMO Renewable Resources has separately signed up to UN PRI

GMO Renewable Resources, LLC (GMORR), a majority-owned joint venture of GMO LLC, has separately become a signatory of the UN PRI. GMORR is a separately registered investment adviser specializing in direct forestry, farmland and other land-related investments and from its beginning has believed that, in light of its focus on forestry, agriculture and other land-related investments, careful consideration of environmental, social and governance issues is critical to minimizing risk and maximizing returns to its investors. Consequently, ESG principles are integral to the team's investment process as GMORR strives to operate responsibly and sustainably in all aspects of its business.

GMORR typically invests in regions where land ownership rights are well developed. GMORR strives to make choices that improve the long-term sustainability of their activities including (1) enhancing and promoting environmental sustainability; (2) respecting land, resources and human rights; (3) social sustainability, including maintaining consistent safety standards; and (4) good governance, including close supervision of financial and operating activities. In addition to being a signatory of the UN PRI, GMORR typically seeks certification for its timberland assets under a national or international standard except in (1) situations where it does not have full control and in (2) Greenfield projects which do not yet have cash flow to support the costs of certification. GMORR is also exploring the development of metrics and monitoring processes to measure factors that contribute to sustainability on agricultural properties.

Summary

In conclusion, our primary mission as an investment management firm is to deliver the best risk-adjusted returns for our clients. As described more fully above, there are certainly instances where ESG-related factors are considered, but only to the extent that we believe they lead to better risk-adjusted returns for our clients.

**GMO UK Ltd Statement
of Policy on the Principles
of the UK Stewardship
Code**

Revised: October 2012

This statement sets forth the position of GMO UK Limited (“GMO”) with respect to the Principles of the UK Stewardship Code (the “Principles”), outlined in Appendix A of this policy. GMO does not claim compliance with the Principles; however, GMO’s clearly articulated proxy voting policies (and management of the conflicts that may arise therefrom) are integral to our investment processes and capture the broader themes included in the Principles. We believe this approach to stewardship is consistent with GMO’s overriding objective of delivering the best risk-adjusted returns for each of the strategies that the firm offers.

Principles 1, 2, 3, 6 and 7

For all GMO funds and client accounts where GMO has been delegated proxy voting authority, GMO has engaged Institutional Shareholder Services “ISS” for this purpose. ISS undertakes research, makes voting recommendations and ensures that proxy votes are submitted in a timely manner on behalf of GMO’s funds and clients who have granted GMO proxy voting authority. Details of GMO’s voting policy, including default positions on matters of corporate governance and approach to managing the conflicts that may arise in the course of voting proxies are a matter of public record, and are available from GMO upon request.

Reports on the proxy voting activities of GMO funds and separately managed accounts are available to shareholders and clients, respectively, upon request.

Principles 4 and 5

The majority of GMO’s investment strategies employ quantitative techniques, which are primarily focused on identifying groups of stocks that GMO believes will outperform over a market cycle based on GMO’s proprietary valuation models. For these strategies, GMO generally favours the objectivity that a data-based approach to investing provides. Other than with respect to a minority of strategies where fundamental investment and research is a component of an investment strategy, GMO does not have a practice of dialogue, engagement or intervention with portfolio companies. Accordingly, GMO does not generally participate with other investment managers or institutional investors in collective engagement of companies.

Appendix A

Principles of the UK Stewardship Code

Institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities;
2. have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed;
3. monitor their investee companies;
4. establish clear guidelines on when, and how they will escalate their activities as a method of protecting and enhancing shareholder value;
5. be willing to act collectively with other investors where appropriate;
6. have a clear policy on voting and disclosure of voting activity; and
7. report periodically on their stewardship and voting activities.

The UK Stewardship Code

Statement of Compliance

Longview Partners is a specialist asset management company, focussed entirely on the management of Global portfolios. As fiduciaries of our clients' assets, Longview Partners strives to invest in companies that adopt and pursue responsible business practices and are fully accountable to their shareholders.

The UK Stewardship Code, ('the Code'), sets out a number of principles relating to good practice in engagement by investors with UK companies. At Longview Partners, corporate governance is important in our assessment of the 'Quality' ranking of any potential equity investment that we make on behalf of our clients. We set out below how Longview Partners applies the principles of the Code.

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

The discharge of our stewardship responsibilities is inherent in our rigorous research process. We have in-depth discussions with each company prior to investment and maintain an ongoing dialogue once invested to evaluate the effectiveness of company's management on corporate governance issues. A large part of our research effort is focussed on understanding how the company's management has created value for shareholders in the past and how management will continue to do so in the future. In our company meetings we discuss strategy and corporate responsibility issues with board directors and executives, as we believe that these factors affect the potential for a company to deliver long-term sustainable value to shareholders. Such factors include; remuneration, finance, climate change, reputation and litigation risks, deployment of capital and energy efficiency. Further detail of how we engage and monitor companies in which we invest is outlined in our Responsible Investment Policy. Our policy on the exercise of voting rights on behalf of our clients is outlined in our Shareholder Activism Policy.

On behalf of our Institutional clients we employ the services of the voting agency Glass Lewis & Co, a leading independent provider of corporate governance solutions to the financial services industry. To inform their research, Glass Lewis uses publicly available sources of information such as stock exchanges, regulators, companies directly or other forms of direct procurement. Glass Lewis votes on our clients' behalf at all relevant company meetings.

Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

Longview Partners seeks to always act in the best interests of our clients and where possible avoid conflicts, including those which may arise through voting or engagement. Occasions may arise where a conflict or perceived conflict of interest exists. In such instances, all reasonable steps are taken to ensure that we put the interests of our clients first, as outlined in our Conflicts of Interest Policy.

If Longview manages assets for a company pension plan or related entity, Longview will respect client restrictions but beyond that will vote proxies in that company in the best interest of our clients and consistent with our voting policy and Glass Lewis' recommendations.

Principle 3: Institutional investors should monitor their investee companies.

Longview Partners believes that companies need to be managed in the interests of shareholders. Our investments are focused in companies with good corporate governance, as we believe they are more likely to deliver sustainable, long-term value to their shareholders. Integrated within our investment process is the consideration of risks and opportunities such as government legislation, industry dynamics, mergers and acquisitions and product development/innovation. When we meet company management, we engage with them on finance and remuneration schemes as well as strategy and performance expectations, such as their capital deployment strategy and any other issues and risks facing the business. We evaluate the effectiveness of a company's management and if its past, current or anticipated behaviour is judged to be adverse to its future earnings, these concerns are addressed in our fundamental research and investment process. Poor performance on corporate governance would be reflected in our longer term Quality rating that we assign companies. Any concerns we have with company practices would be proactively addressed in order to protect shareholder value.

On an ongoing basis, we encourage high standards of corporate governance when we meet with senior management of a company, as we recognise that both financial and governance issues can affect the sustainability and long-term performance of the company. We engage with companies on corporate governance issues as part of our overall investment strategy. "Engagement" to us means that we seek to meet with company board directors and executives to discuss strategy and corporate responsibility issues. We are comfortable discussing any contentious issues on company meeting agendas and have ongoing dialogue with management regarding the outlook of the business and the issues and risks affecting it. Consequently, we are able to evaluate any resulting management decisions and actions. We will also discuss the quality of the company's reporting as well as the finance and remuneration schemes and strongly support those that align management's interests with those of shareholders. We incorporate the results from our engagement into our investment criteria. Whilst we put our views forward strongly in these meetings, we do not consider ourselves activist. Ultimately, if after lengthy discussions we believed management was failing to act in shareholders' interests, we would tend to sell our holding in order to minimise the loss of shareholder value.

Longview does not send a representative to attend General Meetings of companies. We engage directly with the management of the companies in which we are invested and do not feel that attendance to these meetings would be the appropriate use of our investment resources.

Longview Partners does not encourage becoming an insider. In the unlikely event that we are made an insider or given material information that has not yet been published, we would follow our policy and procedure on Market Abuse.

Principle 4: Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

The primary focus of Longview's investment process is to understand the quality of a company and the value of the cash-flows that it can generate. Within our analysis of quality, a large focus is on understanding management's approach to the reinvestment of cash generated and balance sheet management. We do not seek to prescribe a specific approach, rather we ask management to be thoughtful of their actions and to show that due consideration has been given to all options, with an aim of maximising shareholder returns. If we believe management has a poor track record of doing this or inappropriate plans for the future, we will not invest in a company, even if it has other positive investment merits. Where we have concerns that the company's management is not acting in shareholders' interests, our investment team will make clear our concerns to the company. As a concentrated long-term investor we often find company management appreciative of our input.

In our continual assessment of our investments, we have on-going dialogue with the management of companies, in which we are invested or may be invested, to ensure that they are meeting a reasonable governance hurdle. Areas

where we believe they are deficient will be highlighted and our expected levels of performance on governance issues will be made clear. We will closely review a company's performance, governance, remuneration and approach to risk. Anything likely to cause a material change in the value of the business, or our quality rating for the business, will be reviewed by the investment team. If an issue is serious enough that it is likely to cause a material change in our valuation of the business, or a reduction in our quality rating, we will write to senior management or express our views through robust discussions with the appropriate member of the management team. We are willing to challenge management in an attempt to protect and enhance the interests of our clients and will exercise our right to vote against management. As mentioned above, if after lengthy discussions we believed management was failing to act in shareholders' interests, we would tend to sell our holding in order to minimise the loss of shareholder value.

Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate.

Our policy on engagement focuses on meetings and dialogue with company directors and management on a one-on-one basis. Collective engagement with other shareholders would be considered if we believed this would result in a more positive outcome for our clients, is consistent with our policies and procedures and meets all legal requirements. For example, collective engagement would be considered prior to an important company vote, where we felt that our ability to lobby other investors may result in a more positive outcome for our clients. However, we would anticipate collaboration at this level to be infrequent.

Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.

We carry out proxy voting for all Institutional clients who request Longview Partners to be responsible for the implementation of their voting rights. In order to effectively meet these requirements, Longview engages Glass Lewis as described above. We believe Glass Lewis' expert and independent analysis on governance complements Longview's stock selection process. However, Longview Partners would advocate the exercising of votes, and where necessary, objective and informed intervention in line with our Shareholder Activism Policy.

Proxy voting reports are provided on a quarterly basis to all clients on whose behalf we vote. Given the concentrated nature of our portfolio, we believe it is in our client's best interest to preserve the confidentiality of our holdings and we therefore do not make voting activity data publicly available.

Longview Partners does not engage in stock lending as part of our investment management activity for clients. However, our clients are able to engage in stock lending for their specific portfolio, through arrangements made directly with their custodian.

Principle 7: Institutional investors should report periodically on their stewardship and voting activities.

On a quarterly basis, we report to our institutional clients our stewardship activities, including engagement activity. Through our voting service provider, we are able to access and provide reports to our clients showing how their shares have been voted.

An independent audit is carried out to ensure we are conducting our activities in line with the AAF 01/06 standards. Part of the independent audit includes a review of the voting process. The AAF 01/06 report is available to existing clients of Longview Partners as per our engagement letter with our auditors.

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Oldfield Partners

Statement of compliance with the UK Stewardship Code

Oldfield Partners LLP (OP) is an asset management firm which started business in 2005. The firm manages around £3 billion in long only equity portfolios for a variety of clients.

We believe that our long term approach to investing benefits from a broad understanding of a company's position in the world, part of which is captured in the UK Stewardship Code, rather than a narrow focus on today's market position and profitability alone. As long term investors we support the general intentions of the code and believe our approach is in line with its basic principles.

Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

OP policy is as set out in this document, which is published on our website. The investment team is responsible for discharging our stewardship responsibilities and our approach to investing is based on fundamental, bottom-up company analysis. As part of our research process we aim to understand how a company, and to some degree its management, create long term value for shareholders. This involves a review of company statements, reports and actions, and in many cases, an ongoing dialogue with company representatives. For further detail on the dialogue with companies, please refer to sections on monitoring and engagement policy.

For those clients that give permission to do so, OP takes responsibility for proxy voting and employs the services of governance expert Institutional Shareholder Services Inc. (ISS) to provide analysis and recommendations which assist decision-making. For further information on this subject, please refer to our proxy voting policy.

OP has an obligation to act in the best interest of its clients and does so in accordance with predefined guidelines and objectives.

For further detail on the approach to stewardship, or to contact us about engagement, please email info@oldfieldpartners.com and we will direct you to the correct member of the team.

Principle 2

Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

OP maintains a comprehensive Conflicts of Interest Policy, which is fully in accordance with regulatory guidelines. OP seeks to act in the best interests of clients and avoid potential conflicts of interest. The policy ensures procedures are in place to identify, manage and document conflicts that arise in the course of business.

A copy of the full policy is available on request and is also published on the firm's website.

Principle 3

Institutional investors should monitor their investee companies.

Our approach to investing is based on fundamental, bottom-up company analysis. In assessing companies for investment purposes, we take into account ethical and governance considerations and the extent to which they may affect prospective returns. We avoid companies in which there are serious governance concerns, and companies in which there have been concerns about business being conducted in an unethical manner unless it is clear that such concerns have been dealt with by management and any shortcomings have been addressed. Such concerns may relate to social and environmental matters as well as other ethical and governance practices.

Investee companies are monitored through regular review of company statements, results, reports and, more importantly, actions. In many cases we are in direct contact with company representatives and have the ability to express views or concerns through this ongoing dialogue. In addition, we use a governance expert, Institutional Shareholder Services Inc. (ISS), to provide analysis of governance issues to assist with proxy voting and GES, a specialist provider of research in the area of responsible investment.

The frequency and intensity of this monitoring may vary from company to company. For example, a small family-controlled business operating in Thailand may require greater scrutiny than a large multinational corporation listed in the UK, but a greater allowance must be made for the stage of its development and its resources.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

The decision to escalate engagement with investee companies is judged on a case-by-case basis and is influenced by factors such as the materiality of the issue and the likelihood of exerting a significant influence. Meeting with company management offers an opportunity for us to put across our views. Occasionally we engage with management to promote a particular course of action or to reflect concern about a particular activity or aspect of governance. We

manage concentrated portfolios of around 20 stocks and this concentration helps us to monitor all holdings effectively.

On an annual basis OP publishes a proxy voting and engagement report which highlights some of the engagement activities and escalation undertaken. This is available on the website.

Principle 5

Institutional investors should be willing to act collectively with other investors where appropriate.

OP may be prepared to communicate, and potentially collaborate, with other shareholders sharing the same views but only if it was likely to result in a positive outcome for clients and would not infringe any legal or regulatory requirements. We recently joined an investor forum organised by the Association of British Insurers for this specific purpose and have had discussions with the UK Investor Forum and the FRC about the hurdles currently preventing more widespread collaboration.

Principle 6

Institutional investors should have a clear policy on voting and disclosure of voting activity.

OP employs the services of governance expert Institutional Shareholder Services Inc. (ISS) to manage the voting of proxies and assist our decision-making. ISS provide analysis and voting recommendations for each proposal and we tend to vote in line with ISS recommendations unless we have a conflicting opinion about a particular issue, in which case we will intervene to instruct as we see fit, or if we feel it is not in our clients' best interests to vote (due to share blocking for example).

ISS voting policies reflect best practice within the industry and are extremely thorough. For example, the policy applied by ISS in the UK is that of the National Association of Pension Funds (NAPF), and the policy manual for the US runs to over 300 pages. The voting policies of ISS are effectively the voting policies of Oldfield Partners, applied in all but a relatively small number of incidences where because of company-specific factors we may take a different view and vote accordingly.

Where a client has specific proxy voting guidelines which differ from ISS, we work with ISS to ensure we vote in line with the guidance prescribed by the client.

Proxy voting records are retained and provided to clients when requested. OP also publishes an annual summary of proxy voting and engagement on its website.

Oldfield Partners does not engage in stock lending, although clients with segregated accounts may have separate programmes managed by custodians or other third parties. In these cases, the programmes operate independently of us and we have no influence or involvement.

Principle 7

Institutional investors should report periodically on their stewardship and voting activities.

At the client's request, OP provides regular reports of stewardship activities, including detailed proxy voting records pertaining to the individual client.

The frequency and exact requirements of the reporting are agreed between OP and the client at the inception of the mandate and are generally incorporated into the investment management agreement.

As noted under Principle 6, an annual summary of proxy voting and engagement activity is publicly disclosed via the website.

Our proxy voting control processes are detailed in our AAF 01/06 Assurance Report on Internal Controls which is independently verified by external auditors and available to clients on request.



Oldfield Partners

Environmental, Social, Governance Q&A

ESG statement

In assessing companies for investment purposes, OP takes into account ethical considerations and the extent to which ethical factors may affect prospective returns. We avoid companies about which we have serious governance concerns, and companies in which we have concerns about business being conducted in an unethical manner unless it is clear that such concerns have been or are being dealt with by management and any shortcomings have been addressed. Such concerns may relate to social and environmental matters as well as to other ethical practices. We do not have a prohibition on any particular sectors or countries. To view our statement of compliance with the UK Stewardship Code, please [click here](#).

1. Is your organisation a signatory of the UN Principles of Responsible Investment? Has your organisation issued a Statement of Commitment to the FRC Stewardship Code? Please list any other relevant codes / organisations that your firm is a signatory of or affiliated to.

We are not currently a UN PRI signatory, as we are not yet comfortable that Principle 5 (working together to enhance effectiveness in implementing the Principles) has the necessary infrastructure and protections we think necessary. We have held numerous conversations with the Financial Reporting Council in the UK on this issue and have made clear our concerns about engaging or collaborating with other managers when it is not clear whether they have long or short positions. However, we have recently joined the Investor Forum, hoping this can provide the platform for the kind of collective efforts the PRI promotes.

We publish a statement of commitment to the UK Stewardship Code on our website: <https://www.oldfieldpartners.com/investment-philosophy>

2. Do you recognize that ESG issues can impact long term shareholder returns for companies?

Yes, which is why as a long term investor we believe ESG should form part of our research process. OP takes into account ethical considerations and the extent to which ethical factors may affect prospective returns, but our focus remains on the prospective returns, which drive our decision-making.

3. Do you incorporate ESG issues into investment research and decision-making processes, including proxy-voting?

Yes. ESG issues are considered routinely in our research on companies, and where appropriate we engage with companies regarding such issues. We also employ the services of specialist consultants such as GES (Global Ethical Standards), to help highlight key ESG issues and give us the ability through them to influence the large number of institutional investors they support in this area. However, we do not seek necessarily to avoid companies with ESG issues: in such circumstances, provided that we think that prospective investment returns justify our involvement, we may seek to engage with management in order to influence policy.

OP also employs the services of governance expert Institutional Shareholder Services Inc. (ISS) to manage the voting of proxies and assist our decision-making. ISS provide analysis and voting recommendations for each proposal which we thoroughly review. We instruct them to vote the proxies for all clients where we have permission to and to vote in line with ISS unless we have a conflicting opinion about a particular issue, in which case we will intervene to instruct as we see fit, or if we feel it is not in our clients' best interests to vote (due to share blocking for example).

Where a client has specific proxy voting guidelines which differ from ISS, we work with ISS to ensure we vote in line with the guidance prescribed by the client.

4. Do you have a separate ESG Committee?

No, ESG is the responsibility of the investment team and is integrated into the research process.

5. Do you seek appropriate disclosure on ESG issues that can impact long term shareholder returns, from the companies in which you invest?

Yes. Through our own research and that provided by consultants, we are able to raise concerns relating to significant issues with companies and then engage with them over a period of time to encourage change and improvement.

6. Who are your ESG research providers?

We use research and data from Bloomberg, GES and ISS. We are also a member of the Investor Forum in the UK which allows shareholders a collective voice in engaging with companies on issues which may include ESG concerns, although to date this has focused on UK companies.

7. Briefly discuss how you incorporate ESG into the investment process, with an example, keeping in mind issues like:

a) Identification of ESG risk and opportunity; and

The investment team is responsible for identifying ESG issues but we use the services of Bloomberg, GES, ISS and other sources to assist us in this process. Significant issues are considered as part of the research process and discussed as necessary. This may lead to engagement with the company in question, particularly if it is an existing, rather than potential, holding.

When we purchased Chesapeake in Q3 2012, it had previously been at the centre of a corporate governance scandal. The scandal revolved around the actions and compensation of the CEO, Aubrey McLendon, who at the time of the scandal was also Chairman of the board of directors. The main problem was that he participated in a Founders Well Participation Programme which allowed him to decide at the start of each year whether he wished to take a 2.5% stake in all of the wells the company drilled that year. When the company was first formed in 1989 this was a generous but perhaps appropriate incentive but as the firm grew to become very large, this was no longer appropriate. Once these issues came to light, it was clear that the board did not have sufficient control and oversight of what McLendon was doing. However, this scandal resulted in a dramatic fall in Chesapeake's share price and left the valuation of the company at very low levels, hence offering an opportunity.

However, before we could invest, we had first to be comfortable with the new corporate governance arrangements as a hurdle to considering investment. The replacement of nearly the whole board, with a powerful chairman and directors including Lou Simpson, and the end of the chief executive's programme of participation in Chesapeake's production, satisfied us that the inappropriate governance belonged to the past, and therefore provided an opportunity.

b) Management and monitoring of ESG risks and opportunities

In addition to the processes already noted, ongoing ESG issues and engagement are logged centrally and reviewed by senior investors regularly, with progress reports and action points recorded and discussed as necessary.

8. Please describe your research and engagement policy on each of the topics below, using examples where helpful:

a) Climate change and stranded carbon assets;

In managing our equity portfolios and engaging with company managements, there are both negative and positive aspects to our assessment of the risks and opportunities created by climate change. In analysing resource companies, we have not hitherto adopted a "stranded assets" approach to our assessment of reserves in which a large proportion of reserves might be discounted as unlikely ever to reach production. However, we are strongly conscious of the need to discriminate between different types of resource. In particular, we are sceptical about the valuation multiples which should be attributed to coal resources because of the environmental impact of coal and the possibility that thermal coal becomes obsolete in developed markets. We view positively, in our projections and valuation, businesses which are likely to mitigate climate change and more broadly pollution, and we therefore favour businesses which lead to lower energy usage. In the auto sector, for example, in which we have recently had substantial holdings, we focus, when engaging with management and when studying the company's business, on fuel efficiency, and on the long term displacement of gasoline dependent vehicles by vehicles dependent on other sources of energy. Within the energy sector, we favour natural gas as a resource which is at least relatively climate-friendly, and we have also, from time to time including currently, invested in utilities with a nuclear activity.

The result of these emphases takes both a quantitative and a qualitative form: quantitative, in our valuation process; and qualitative, in our textual commentary within our research notes.

We have not actively engaged with a company specifically on the issues of climate change and stranded assets.

b) Executive pay

ISS research with regards to proxy voting is a good starting point for considering executive pay. We vote on all remuneration items and where we feel remuneration is egregious or significantly mis-aligned with shareholders we may engage with management. This is considered on a case-by-case basis. In the past we have engaged with Staples and Barrick Gold.

With Staples, we noted a number of areas of weakness in the executive compensation plans including the metrics – both the actual metrics and the hurdle rates - being used to assess performance. We also discussed vesting periods and claw-back provisions. We welcomed the move away from time-based restricted stock and options.

Our comments were passed on to the board and compensation committee.

c) Boardroom roles and diversity

Again, ISS research is helpful and we vote on all agenda items. However, we have not set specific policy goals for diversity, instead we consider issues on a case-by-case basis.

We had a discussion with Staples with respect to the combined CEO/Chairman role and the recent executive compensation awards. We expressed our view that it would be better to have an independent Chairman but, given the reinvention plan that had been recently announced, it made sense to keep the focus on executing the turnaround plan rather than focusing on whether there should be an independent Chairman. Furthermore, there was good oversight from the rest of the board. Nevertheless, in time, we would rather the CEO and Chairman roles were split.

A key incident of engagement in early 2015 was a meeting with the management of Nintendo, when the company's request to vote in favour of the re-election of directors signalled their anxiety about this. The meeting was helpful in postponing any further sale by us of shares in the company; and was then followed by Nintendo's important announcement of a change in strategy, which we had written to them about previously.

Dear Ian,

Please find below an outline of some of Pantheon's ESG policies as per your email. Pantheon is driven by the conviction that addressing ESG issues is a crucial part of investment risk management; and effective mitigation of these issues can have a notable impact on value creation in private equity and infrastructure investments. ESG initiatives therefore form a key element of Pantheon's investment philosophy and approach.

Pantheon and PRI

Pantheon is a signatory of the Principles for Responsible Investment (PRI) and has used these principles as a framework to develop its ESG policy across all its investment activities. Pantheon was also a founding member of the PRI Private Equity Steering Committee and only withdrew in 2014 due to a maximum tenure being exceeded. Pantheon has remained involved in sub-committees and continues to assist the PRI with logistics and speakers at conferences.

Pantheon is also an endorser of the ILPA Private Equity Principles; and is a member of the EVCA, BVCA and LAVCA Responsible Investment Working Groups.

More generally Pantheon is driven by the conviction that addressing ESG issues is a crucial part of investment risk management; and effective mitigation of these issues can have a notable impact on value creation in private equity and infrastructure investments. Our reputation and market profile as a leading global private equity and infrastructure fund investor; and our strong relationships with both our GPs and LPs, means that we are ideally positioned to promote the importance of ESG within the industries. ESG initiatives therefore form a key element of Pantheon's investment philosophy and approach.

We believe that Pantheon is a market leader in this area, and our approach incorporates:

- Formally taking account of ESG issues in the investment process;
- Engaging with GPs to promote the importance of ESG issues;
- Providing on-going ESG training to Pantheon investment professionals;
- Maintaining ESG risk monitoring post-investment for each underlying asset;
- Endeavouring to keep our LPs aware of the level of ESG risks through pioneering ESG reporting; and
- Encouraging all industry participants to recognize and act on ESG issues.

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Pantheon Ventures (UK) LLP is a limited liability partnership and authorised and regulated by the Financial Conduct Authority in the United Kingdom (FCA Reference No. 520 240).
Registered in England No.OC352463

UK Stewardship Code

Although Pantheon has not yet signed up to the UK Stewardship Code, the principles contained within the UK Stewardship Code are akin to Pantheon's ongoing active engagement with the managers in which we invest. Effective post-investment care and the maintenance of close relationships are important to maximize the value of Pantheon's fund investments, protect client interests and to evaluate the investment activity within each fund. Our active involvement on Advisory Boards of the funds in which we invest, as well as our policy on voting, is outlined below.

Voting Matters

As a PRI signatory, Pantheon has committed to follow a policy of active ownership, requiring us to vote on all matters. In private equity, voting may take place on any number of governance, legal or investment matters and therefore each voting matter is considered on a case by case basis. For this reason, Pantheon does not have an internal reference guide to cover all voting matters.

Private equity ownership can improve businesses by a long term approach, active ownership, close alignment of interest and good corporate governance. In this way, private equity managers are able to add value by taking a highly active role throughout the course of an investment in an underlying company. By nature of its business, Pantheon delegates the responsibility for the selection, monitoring and realization of individual private equity investments to its private equity managers. Our due diligence process is structured to identify managers with the greatest potential to deliver superior performance, and active engagement with underlying companies forms a fundamental element of this. We seek to identify the most experienced and stable management teams who have a strong track record of value creation through operational improvements.

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Statement on the UK Stewardship Code

October 2015

SSGA endeavours to implement the spirit of the UK Stewardship Code across all jurisdictions in which we invest.

State Street Global Advisors (SSGA) is the asset management business of State Street Corporation, one of the world's leading providers of financial services to institutional investors, with \$2.20trn¹ assets under management (as of 30th September 2015).

SSGA is a strong supporter of the principles of good stewardship that are embodied in the UK Stewardship Code. We firmly believe that the building of strong relationships with the boards and management teams of investee companies and the monitoring of their performance is an essential component of enhancing the long-term value of our clients' investments. SSGA endeavours to implement the spirit of the UK Stewardship Code across all jurisdictions in which we invest.

Statement on the UK Stewardship Code

The UK Stewardship Code ("the Code") embraces the idea that all stakeholders in the engagement process play a role in advocating sound corporate governance practices. The Code describes seven basic principles designed to promote the long-term success of companies. SSGA supports the principles of the Code and we are committed to being transparent on how SSGA exercises its ownership responsibilities. SSGA's approach to voting and engagement is described in our Summary of Global Proxy Voting and Engagement Principles, found on the website of SSGA Ltd (www.ssga.com).

SSGA reviews our internal policies, practices and compliance with the Stewardship Code on an annual basis (last reviewed in September 2015).

Statement on the UK Stewardship Code

SSGA's Compliance with the UK Stewardship Code at a Glance

Principles: Institutional investors should...

Principles: Institutional investors should...	SSGA Compliance	Highlights
publicly disclose their policy on how they will discharge their stewardship responsibilities	✓	SSGA's approach to proxy voting and engagement activities is explained in our global proxy voting and engagement guidelines and annual stewardship report.
have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed	✓	Comprehensive standalone Conflicts of Interest Policy to help manage conflicts arising from SSGA's proxy voting and engagement activities.
monitor their investee companies	✓	<p>Annual active monitoring list of companies across all geographies.</p> <p>Proprietary screens that help prioritise specific company engagements on broad range of financial and ESG metrics.</p> <p>Annual review and prioritisation of sector and thematic focus for active engagements.</p> <p>Integrated approach across investment teams.</p>
establish clear guidelines on when and how they will escalate their stewardship activities	✓	<p>Engagement protocol establishes process for escalating stewardship activities.</p> <p>Systematic review of portfolios to identify high-risk companies requiring heightened shareholder attention.</p> <p>Multi-channel communications with company management and boards.</p> <p>Multi-year voting and engagement database captures corporate interactions, identifies issues for follow-up and measures successes.</p>
be willing to act collectively with other investors where appropriate	✓	<p>Developed framework for collaborating and engaging with like-minded investors.</p> <p>Active membership of global and regional investor bodies and networks.</p>
have a clear policy on voting and disclosure of voting activity	✓	<p>Global proxy voting principles and six market specific guidelines reviewed and updated annually.</p> <p>Quarterly and annual proxy voting statistics and engagement highlights complements bespoke client/ fund- specific reporting of voting activities</p>
report periodically on their stewardship and voting activities	✓	Comprehensive annual stewardship report is supplemented by quarterly updates on stewardship activities.

Details of Compliance with Each Code Principle

Principle 1

Institutional Investors should Publicly Disclose their Policy on How they will Discharge their Stewardship Responsibilities

SSGA manages numerous investment strategies on behalf of our clients with various investment viewpoints and objectives. Nevertheless, the value of good governance practices of investee companies is of equal concern and importance under all investment approaches. Consequently, SSGA maintains a centralised governance and active ownership process covering all discretionary holdings. This allows us to ensure we speak and act with a single voice and maximize our influence with companies by leveraging the weight of our entire assets under management on behalf of all clients.

In conducting our voting and engagement activities, SSGA evaluates the various factors that play into the corporate governance framework of a country, including macroeconomic conditions, the political environment, quality of regulatory oversight, enforcement of shareholder rights and the effectiveness of the judiciary. SSGA complements its company specific dialogue with targeted engagement with regulators and government agencies to address systemic market-wide concerns.

SSGA uses a blend of quantitative and qualitative research and data to help identify issuers where active engagement may be necessary to protect and promote shareholder value. Issuer engagement may also be event driven, focusing on specific corporate governance and sustainability concerns or wider industry related trends. SSGA also gives consideration to the size of our total position of the issuer in question and/or the potential negative governance, performance profile, and circumstance at hand. As a result, SSGA believes issuer engagement can take many forms and be triggered under numerous circumstances.

SSGA has a dedicated team of governance experts, based in Boston and London, who are charged with implementing its proxy voting guidelines and engagement activities on a global basis. The activities of the Corporate Governance Team (“CGT”) are overseen by SSGA’s Investment Committee (“IC”). The IC is responsible for approving the annual stewardship strategy, engagement priorities and proxy voting policies, and monitoring the delivery of objectives. Furthermore, the Global Proxy Review Committee (“GPRC”), a dedicated sub-committee of the IC, provides day-to-day oversight of the CGT, including approving departures from policy and management of conflicts of interest.

The CGT is supported by several specialists within SSGA in executing their stewardship responsibilities. These include members of SSGA’s proxy operations team who are responsible for managing fund set up, vote execution, vote reconciliation, share recalls and class action lawsuits, and members of SSGA’s client reporting and compliance teams.

SSGA utilises a variety of third-party service providers to support its stewardship activities. Data and analysis from service providers are used as inputs to help inform SSGA’s position and assist with prioritisation. However, all voting decisions and engagement activities are undertaken in accordance with SSGA’s in-house policies and views, ensuring the interests of our clients remain the sole consideration when discharging our stewardship responsibilities.

Principle 2

Institutional Investors should Have a Robust Policy on Managing Conflicts of Interest in Relation to Stewardship which should be Publicly Disclosed

State Street Corporation has a comprehensive standalone Conflicts of Interest Policy that address a range of conflicts identified by our parent company. In addition, SSGA maintains a conflicts register that identifies key conflicts and describes systems in place to mitigate the risks. SSGA has also published a specific conflicts policy that provides guidance on managing conflicts that may arise through SSGA’s proxy voting activities.

SSGA policies and procedures are designed to prevent undue influence on SSGA’s voting activities that may arise from relationships between proxy issuers or companies and State Street Corporation, SSGA, SSGA affiliates, SSGA Funds or SSGA Fund affiliates; and ensure that the interests of our clients remain our primary consideration.

In general, we do not believe matters that fall within the scope of our guidelines and are voted consistently present any potential concerns, since the vote has effectively been determined without the influence of the soliciting entity. However, in circumstances where a potential conflict has been identified, the matter will be referred to the GPRC who reviews the matter and determines whether a conflict of interest exists, and if so, how to best resolve such a conflict. For example, the GPRC may (i) determine that the proxy vote does not give rise to a conflict due to the issues presented, (ii) refer the matter to the Investment Committee for further consideration or (iii) retain an independent fiduciary to execute the vote on behalf of SSGA.

SSGA’s policy for managing conflicts arising from our stewardship activities is publically available on the SSGA website (<https://www.ssga.com/eu/gb/institutional-investor/en/products-capabilities/capabilities/custom-solutions/corporate-governance-and-voting-policy.html>).

Principle 3

Institutional Investors Should Monitor their Investee Companies

SSGA is a leading global provider of passive fund strategies and holds over 9,000 listed equities across its global portfolios. Therefore, the effectiveness of our engagement strategy is built upon our ability to prioritise, and allocate resources to focus on companies and issues that will have the greatest impact on shareholder returns. To support this process SSGA has developed proprietary in-house screening tools to help identify companies for active targeted engagement based upon various financial and ESG risk indicators. Factors considered in developing the target list include: size of absolute and relative holdings; companies with poor long-term financial performance within their sector; companies identified through the ESG screening tool as lagging market and industry standards; and outstanding concerns from prior engagements.

In addition to issuer specific screening, SSGA develops annual stewardship priority programs to enhance the quality and define the scope of our stewardship activities for the year. This enables SSGA to focus engagement and reporting on sectors and ESG themes that are of increasing importance to our clients. We develop our priorities based on several factors including client feedback, emerging ESG trends, and developing macroeconomic conditions and regulation.

SSGA monitors the performance of investee companies amongst its target list through a combination of in-depth research and analysis and the maintaining of regular channels of communication with boards and senior management. The process has been designed to allow SSGA to better understand the long-term corporate strategy and performance, governance practices, financial controls and risk management systems of companies held in our client portfolios. SSGA will carefully consider ethical, environmental and social factors when deemed to be material to the long-term prospects of a company.

Beyond SSGA's active engagement program, the CGT undertakes base level monitoring of the entire portfolio and participates in reactive engagement in response to company or market specific events.

Based on the outcome of our company analysis and dialogue, SSGA may identify potential concerns or areas for improvement. SSGA will utilise its voting rights and engagement influence to seek positive change at companies with the ultimate objective of enhancing the value of our clients' investments.

The monitoring and engagement process is integrated within SSGA's investment functions to ensure a consistent position across the firm. Investment integration within our passive mandates is primarily realised through SSGA's global and

regional CIOs who participate directly in meetings with companies and regulators. In addition, the CGT collaborates with other members of the passive investment teams on matters related to market policies and company specific events. Integration between the teams is of particular importance when considering corporate restructurings and mergers and acquisitions which may have a significant impact on benchmark index composition and rebalancing.

Under our active strategies, SSGA's CGT works closely with our active fundamental investment teams, collaborating on issuer engagements and sharing inputs on company specific fundamentals. This facilitates an integrated approach towards investment research and engagement with company management and boards. The active equity teams also provide recommendations on all resolutions tabled for shareholder approval at companies within their investment universe.

Under no circumstance is SSGA willing to be made insiders to assist investee company boards and their advisers as part of our engagement process. Companies should take care to ensure that all material information disclosed during engagements with SSGA be publicly available in the market.

In general, SSGA does not attend shareholder meetings. Rather, SSGA votes at all shareholder meetings by proxy where eligible, and believes that proxy voting and engaging with issuers is the most effective means to address governance concerns. To the extent practicable, the CGT will arrange meetings with investee companies prior to the vote, to discuss any areas of concern.

Externally, SSGA is a member or participant in a range of investor based organisations that complement SSGA's internal mechanisms of regularly tracking noteworthy company, industry and regulatory issues and events.

Our monitoring process is reviewed at least annually to ensure that engagement efforts are appropriately targeted and that the process is effective and efficient.

Principle 4

Institutional Investors should Establish Clear Guidelines on When and How they will Escalate their Stewardship Activities

SSGA has published an engagement protocol that provides transparency to companies on our approach to stewardship and the manner in which we prioritise and select engagements. The protocol gives guidance on how and when companies should approach SSGA and sets out expectations for the development and maintenance of long-term and constructive relationships with shareholders (<https://www.ssga.com/eu/gb/institutional-investor/en/products-capabilities/capabilities/custom-solutions/corporate-governance-and-voting-policy.html>).

Statement on the UK Stewardship Code

SSGA has developed a proprietary portfolio screening tool based on various data points including long-term financial performance, governance and sustainability structures and performance and SSGA's absolute and relative exposure. The screening tool enables the CGT to build an 'active' engagement target list of companies for each geographical region. This is complemented by the adoption of annual thematic and sector priorities designed to balance our risk-based approach with wider industry coverage. *The annual engagement prioritisation process is described in greater detail under Principle 3.*

Depending on the issue and whether the engagement activity is reactive, recurring, or active, engagement with issuers can take the form of written communication, conference calls, or face-to-face meetings. While the Stewardship Code is specific to UK stakeholders, SSGA conducts the same engagement practices globally.

The engagement process will depend on the nature of the issue that is being addressed. Matters related to execution of strategy, finance, operations and risk management will ordinarily be directed towards representatives of the senior executive team. While communications focused on wider strategic considerations and the structure, effectiveness and responsibilities of the board and oversight of the broader governance regime will normally be channelled through relevant members of the board.

SSGA will consider escalating concerns if engagement has failed to result in a satisfactory outcome. The specific steps of the escalation process will depend upon the subject and seriousness of the concern, and the openness and responsiveness of the company. SSGA will consider escalating concerns to the company chairman, senior independent director, and where appropriate, the relevant regulatory authority. SSGA will also consider collaborating with other like-minded investors provided there is alignment with the engagement objectives and desired outcomes.

Our experiences and conclusions reached during the engagement process will help shape SSGA's voting decisions on relevant ballot items and when considering the continued suitability of directors that are standing for re-election.

To enable engagement continuity, the CGT maintains a database that allows us to record both our engagements and the details of our voting analysis in contentious situations. The multi-year engagement database ensures that issues identified for follow-up are carried through in subsequent engagements and that positive changes implemented by companies are captured.

Principle 5

Institutional Investors should be Willing to Act Collectively with Other Investors where Appropriate

The size of SSGA's global assets and reputation in the market provides the CGT with access to the management and boards of investee companies. Therefore, the majority of corporate engagements are carried out on a one-to-one basis behind closed doors, as we feel this is critical to building trust and establishing constructive long-term relationships with companies. Nevertheless, SSGA collaborates with like-minded investors under certain circumstances. Factors that are considered when determining the merits of collaborative action include:

- Agreement amongst investors on core areas of concern and potential solutions;
- Systemic market-wide concerns and regulatory environment;
- Responsiveness of management and boards to prior individual engagements;
- Concentrated ownership within the share register; and,
- Market culture and acceptance of shareholder engagement.

To facilitate this process, SSGA are members of national and global investor bodies including the UK Investment Association, The Investor Forum, International Corporate Governance Network, Asian Corporate Governance Association, the Council of Institutional Investors and the United Nations Principles for Responsible Investment. In addition, through our membership in various industry networks, as well as our contact with corporate pension plans, public funds and unions, we are able to communicate extensively with other stakeholders regarding events and issues relevant to individual corporations, general industry trends and current shareholder concerns.

Principle 6

Institutional Investors should have a Clear Policy on Voting and Disclosure of Voting Activity

SSGA has developed voting guidelines which are approved and overseen by the IC. The general principles and six market specific guidelines are available for public review on the SSGA website (<https://www.ssga.com/eu/gb/institutional-investor/en/products-capabilities/capabilities/custom-solutions/corporate-governance-and-voting-policy.html>).

These policies have been designed to encourage better governance practices at investee companies based upon SSGA's understanding of global principles of good governance, while taking account of local market nuances and standards where appropriate.

Statement on the UK Stewardship Code

SSGA votes at over 14,000 meetings on an annual basis and tiers companies based on factors including the size of our holdings, past engagement, corporate performance, and voting items identified as areas of potential concern. Based on this assessment, SSGA will allocate appropriate time and resources to shareholder meetings and specific ballot items of interest, to maximise value for our clients. All voting decisions are exercised exclusively in accordance with SSGA's in-house policies or specific client instructions. SSGA has established robust controls and auditing procedures to ensure that votes cast are executed in accordance with SSGA instructions. SSGA has contracted Institutional Shareholder Services ("ISS") to assist with the management of the voting process and provide inputs into the research of shareholder meetings. SSGA utilises ISS's services in three ways: (1) as SSGA's proxy voting agent (providing SSGA with vote execution and administration services); (2) for applying SSGA's Proxy Voting Guidelines; and (3) as providers of research and analysis relating to general corporate governance issues and specific proxy items. We provide SSGA's current policy on proxy voting and engagement to our institutional clients and a summary of this policy (Summary of Global Proxy Voting and Engagement Principles); along with quarterly reports detailing voting activity for the SSGA MPF funds which is published on the SSGA Ltd website. The voting activity reports include company details, proposal type, resolution description, and SSGA's vote cast. We publicly disclose SSGA's voting policy and voting activity for our US registered mutual funds as part of our annual N-PX reporting requirements to the SEC.

SSGA votes in all markets where it is feasible; however, SSGA may refrain from voting when meeting specific power of attorney documentation is required; where voting will have a material impact on our ability to trade the security; where issuer-specific special documentation is required; or various market or issuer certifications are required. SSGA is unable to vote proxies when certain custodians, used by our clients, do not offer proxy voting in a jurisdiction or when they charge a meeting specific fee in excess of the typical custody service

agreement. From time to time, SSGA may recall securities on loan for proxy voting purposes if the result of a particular proxy voting ballot item is deemed to be significant enough to justify the loss of fees from lending for our clients.

Principle 7

Institutional Investors should Report Periodically on their Stewardship and Voting Activities

We recognize the importance of being accountable to our clients on the manner in which we fulfil our duties as responsible owners on their behalf. We aim to provide transparency of our stewardship activities through our regular client reports and other information reported publicly online.

SSGA publishes an annual stewardship report which provides details of our stewardship approach, engagement and voting activities during the year, perspectives on governance and sustainability trends and themes, and forward looking priorities. The annual report is supplemented by a quarterly stewardship activity report and the quarterly publication of our voting record (<https://www.ssga.com/eu/gb/institutional-investor/en/products-capabilities/capabilities/custom-solutions/corporate-governance-and-voting-policy.html>).

¹ AUM reflects approx. \$24.5 billion as of September 30, 2015) with respect to which State Street Global Markets, LLC (SSGM) serves as marketing agent; SSGM and State Street Global Advisors are affiliated.

SSGA's stewardship policies and procedures related to proxy voting, corporate engagement and the management of conflicts are subject to regular review by internal audit.

Key Contacts for SSGA Corporate Governance Team

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Statement on the UK Stewardship Code

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The views expressed in this material are the views of the Corporate Governance Group through the period ended September 30, 2015 and are subject to change based on market and other conditions.

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**REPORT FOR: PENSION FUND
COMMITTEE**

Date of Meeting: 9 March 2016

Subject: Work Programme for 2016-17

Responsible Officer: Dawn Calvert, Director of Finance

Exempt: No

Wards affected: All

Enclosures: None

Section 1 – Summary and Recommendation

Summary

This report presents a draft work programme for 2016-17 on which the Committee's comments and agreement are requested.

Recommendation

That, subject to any comments the Committee wish to make, the work programme for the period up to March 2017 be agreed.

Section 2 – Report

1. Below is a draft for the Committee to consider as its programme of work for the next financial year.

21 June 2016

Performance of fund managers for quarter ended 31 March 2016
Investment manager monitoring
Pooling and London Collective Investment Vehicle
Review of Governance Compliance Statement
Risk Register
Training Programme for 2016-17
Annual Report and Financial Statements 2015-16
Performance Review 2015-16 by State Street Global Services
Issues raised by Pension Board
Work programme for 2016-17

6 September 2016

Performance of fund managers for quarter ended 30 June 2016
Investment manager monitoring
Pooling and London Collective Investment Vehicle
Update on triennial valuation
Lead Member roles
Long term cashflow and funding
Review of Statement of Investment Principles
Investment management expenses
Work programme for 2016-17

September – “Meet the Managers”

22 November 2016

Performance of fund managers for quarter ended 30 September 2016
Investment manager monitoring
Pooling and London Collective Investment Vehicle
Review of Liability Driven Investment
Update on triennial valuation
Issues raised by Pension Board
Work programme for 2016-17 and 2017-18

7 March 2017

Performance of fund managers for quarter ended 31 December 2016
Investment manager monitoring
Pooling and London Collective Investment Vehicle
Monitoring of operational controls at managers
External audit plan
Results of triennial valuation
Training programme 2017-18
Work programme for 2017-18

2. The Committee will have the opportunity to update this programme at every meeting but are invited to comment on the draft programme above and agree it at this stage.

3. In addition to the Committee's work programme training opportunities will be offered for an hour prior to each meeting.

Financial Implications

4. There are no financial implications arising from this report.

Risk Management Implications

5. The Pension Fund has a risk register which includes the risks associated with the recommended work programme.

Equalities implications

6. There are no direct equalities implications arising from this report.

Council Priorities

7. Whilst the financial health of the Pension Fund directly affects the level of employer contribution which, in turn, affects the resources available for the Council's priorities there are no impacts arising directly from this report.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert	<input checked="" type="checkbox"/>	Chief Financial Officer
Date: 25 February 2016		
Name: Caroline Eccles	<input checked="" type="checkbox"/>	on behalf of the Monitoring Officer
Date: 25 February 2016		

Ward Councillors notified:	Not applicable
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Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager 0208 424 1450

Background Papers - None

**REPORT FOR: PENSION FUND
COMMITTEE**

Date of Meeting: 9 March 2016

Subject: **Information Report** – Performance of Fund Managers for Quarter Ended 31 December 2015 and Valuation at 31 January 2016.

Responsible Officer: Dawn Calvert, Director of Finance

Exempt: No

Wards affected: All

Enclosures: Appendix 1 – Fund Valuation
Appendix 2 – Fund Performance

Section 1 – Summary

The report sets out the performance of the investment managers and of the overall Fund for the quarter, year and three years ending 31 December 2015 and the valuation at 31 January 2016.

FOR INFORMATION

Section 2 – Report

1. Attached to the report are tables summarising the Fund valuation at 31 December 2015 and 31 January 2016 (Appendix 1) and Fund performance as at 31 December 2015 (Appendix 2).
2. As calculated by State Street Global Services, the Fund return in the quarter to 31 December 2015 of 4.3% was 0.6% below benchmark due mainly to underperformance within the equities mandates.
3. The one year return of 2.4% is below the benchmark of 2.9% due mainly to the disappointing performance of the Oldfields equities mandate (-6.0%) and the diversified growth funds (-4.7%), partly offset by the good relative performance of the GMO emerging markets equities mandates..
4. The value of the Fund at the end of December had increased over the quarter from £624m to £651m (£675m as at 31 March 2015) but, in January had fallen back to £638m due largely to the performance of the equities mandates.

Financial Implications

5. Asset allocation and manager performance are the two drivers of investment returns.

Risk Management Implications

6. All investment risks are included within the Pension Fund Risk Register.

Equalities implications

7. There are no direct equalities implications arising from this report.

Council Priorities

8. Investment performance has a direct impact on the financial health of the Pension Fund which directly affects the level of employer contribution which then, in turn, affects the resources available for the Council's priorities

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert



Director of Finance

Date: 25 February 2016

Ward Councillors notified:

NO

Section 4 - Contact Details

Contact: Ian Talbot, Treasury and Pension Fund Manager 0208 424 1450

Background Papers - None

Total Portfolio Allocation by Manager & Asset Class

31 December 2015 and 31 January 2016

Asset Class	Value 31.03.2015 £'000	Value 31.12.2015 £'000	Value 31.01.2016 £'000	Allocation 31.01.2016 %	Strategic Allocation %	Strategic Range %
Global Equities						
Longview	75,561	73,123	69,886	11	11	
State Street	220,601	213,270	208,263	32	31	
GMO	76,541	68,746	67,665	11	10	
Oldfields	77,276	70,380	67,643	11	10	
Total Global Equities	<u>449,979</u>	<u>425,519</u>	<u>413,457</u>			
Total Equities	<u>449,979</u>	<u>425,519</u>	<u>413,457</u>	<u>65</u>	<u>62</u>	<u>58-68</u>
Private Equity						
Pantheon	22,954	21,253	21,253			
Total Private Equity	<u>22,954</u>	<u>21,253</u>	<u>21,253</u>	<u>3</u>	<u>5</u>	<u>4-6</u>
Property						
Aviva	50,562	53,430	53,510			
Total - property	<u>50,562</u>	<u>53,430</u>	<u>53,510</u>	<u>8</u>	<u>10</u>	<u>8-12</u>
Bonds						
Blackrock - FI	69,247	65,989	67,176	11	10	10
Blackrock - IL	17,130	16,330	17,497	3	3	3
Total Bonds	<u>86,377</u>	<u>82,319</u>	<u>84,673</u>	<u>14</u>	<u>13</u>	<u>11-15</u>
Alternatives						
Insight	28,857	27,057	26,576	4	5	5
Standard Life	30,678	30,203	29,572	5	5	5
Total Alternatives	<u>59,535</u>	<u>57,260</u>	<u>56,148</u>	<u>9</u>	<u>10</u>	<u>8-12</u>
Cash & NCA						
Cash Managers	865	851	455			
Cash NatWest	4,632	9,245	9,257			
Record passive currency hedge	-2,649	-3,764	-4,637			
Cash Custodian (JP Morgan)	1,433	3,514	1,439			
Debtors and Creditors	1,157	1,736	2,839			
Total Net Current Assets	<u>5,438</u>	<u>11,582</u>	<u>9,353</u>	<u>1</u>	<u>0</u>	
Total Assets	<u>674,845</u>	<u>651,363</u>	<u>638,394</u>	<u>100</u>	<u>100</u>	

Investment Performance – 31st December 2015

Asset Class	Quarter			Year			Three Years/[inception]		
	Fund	Benchmark	Relative	Fund	Benchmark	Relative	Fund	Benchmark	Relative
	%	%	%	%	%	%	%	%	%
Global Equities									
Longview	3.0	6.2	-3.2	3.0	2.1	0.9	16.5	13.0	3.5
State Street	8.0	8.1	-0.1	3.9	3.8	0.1			
GMO	3.6	3.5	0.1	-1.6	-9.7	8.1			
Oldfields	6.2	8.4	-2.2	-1.1	4.9	-6.0			
Total	5.7	6.6	-0.9	1.6	1.4	0.2			
Bonds									
Blackrock									
Corporate Bonds	0.5	0.3	0.2	0.0	-0.1	0.1	5.2	5.4	-0.2
Index Linked	-3.0	-3.3	0.3	-0.7	-1.2	0.5	6.6	6.4	0.2
Total	-0.2	-0.4	0.2	-0.2	-0.3	0.1	5.4	5.6	-0.2
Property									
Aviva	2.7	2.8	-0.1	11.8	12.5	-0.7	12.6	12.9	-0.3
Total	2.7	2.8	-0.1	11.8	12.5	-0.7	12.6	12.9	-0.3
Private Equity									
Pantheon	11.3	8.1	3.2	20.5	4.0	16.5	17.6	5.0	12.6
Total	11.3	8.1	3.2	20.5	4.0	16.5	17.6	5.0	12.6
Alternatives									
Insight	0.3	1.1	-0.8						
Standard Life	1.7	1.1	0.6	2.8	4.6	-1.8			
Total	1.0	1.1	-0.1	-0.1	4.6	-4.7			
Total Fund	4.3	4.9	-0.6	2.4	2.9	-0.5	9.3	9.3	0.0
* Adjusted for currency overlay									
Contributions									
Asset Allocation			-0.1			-0.6			-0.4
Stock Selection			-0.5			0.1			0.4

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