SPECIAL PENSIONS COMMITTEE

Tuesday, 6th December, 2016

at 4.00 pm

Room 102, Hackney Town Hall, Mare Street, London E8 1EA

Membership:

Councillor Kam Adams
Councillor Robert Chapman (Chair)
Councillor Feryal Demirci
Councillor Michael Desmond (Vice-Chair)
Councillor Patrick Moule
Councillor Geoff Taylor

Co-optees:

Jonathan Malins-Smith

Tim Shields
Chief Executive

Contact:
Rabiya Khatun
Governance Services
Tel: 020 8356 6279
Email: Rabiya.khatun@hackney.gov.uk

The press and public are welcome to attend this meeting

Hackney

AGENDA

Tuesday, 6th December, 2016

ORDER OF BUSINESS

ACCESS AND INFORMATION

Location

Hackney Town Hall is on Mare Street, bordered by Wilton Way and Reading Lane, almost directly opposite Hackney Picturehouse.

Trains – Hackney Central Station (London Overground) **–** Turn right on leaving the station, turn right again at the traffic lights into Mare Street, walk 200 metres and look for the Hackney Town Hall, almost next to The Empire immediately after Wilton Way.

Buses 30, 48, 55, 106, 236, 254, 277, 394, D6 and W15.

Facilities

There are public toilets available, with wheelchair access, on the ground floor of the Town Hall.

Induction loop facilities are available in Committee Rooms and the Council Chamber

Access for people with mobility difficulties can be obtained through the ramp on the side to the main Town Hall entrance.

Copies of the Agenda

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Paper copies are also available from Governance Services whose contact details are shown on the front of the agenda.

Council & Democracy- www.hackney.gov.uk

The Council & Democracy section of the Hackney Council website contains details about the democratic process at Hackney, including:

- Mayor of Hackney
- Your Councillors
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- Speaker
- MPs, MEPs and GLA
- Committee Reports
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RIGHTS OF PRESS AND PUBLIC TO REPORT ON MEETINGS

Where a meeting of the Council and its committees are open to the public, the press and public are welcome to report on meetings of the Council and its committees, through any audio, visual or written methods and may use digital and social media providing they do not disturb the conduct of the meeting and providing that the person reporting or providing the commentary is present at the meeting.

Those wishing to film, photograph or audio record a meeting are asked to notify the Council's Monitoring Officer by noon on the day of the meeting, if possible, or any time prior to the start of the meeting or notify the Chair at the start of the meeting.

The Monitoring Officer, or the Chair of the meeting, may designate a set area from which all recording must take place at a meeting.

The Council will endeavour to provide reasonable space and seating to view, hear and record the meeting. If those intending to record a meeting require any other reasonable facilities, notice should be given to the Monitoring Officer in advance of the meeting and will only be provided if practicable to do so.

The Chair shall have discretion to regulate the behaviour of all those present recording a meeting in the interests of the efficient conduct of the meeting. Anyone acting in a disruptive manner may be required by the Chair to cease recording or may be excluded from the meeting. Disruptive behaviour may include: moving from any designated recording area; causing excessive noise; intrusive lighting; interrupting the meeting; or filming members of the public who have asked not to be filmed.

All those visually recording a meeting are requested to only focus on recording councillors, officers and the public who are directly involved in the conduct of the meeting. The Chair of the meeting will ask any members of the public present if they have objections to being visually recorded. Those visually recording a meeting are asked to respect the wishes of those who do not wish to be filmed or photographed. Failure by someone recording a meeting to respect the wishes of those who do not wish to be filmed and photographed may result in the Chair instructing them to cease recording or in their exclusion from the meeting.

If a meeting passes a motion to exclude the press and public then in order to consider confidential or exempt information, all recording must cease and all recording equipment must be removed from the meeting room. The press and public are not permitted to use any means which might enable them to see or hear the proceedings whilst they are excluded from a meeting and confidential or exempt information is under consideration.

Providing oral commentary during a meeting is not permitted.

ADVICE TO MEMBERS ON DECLARING INTERESTS

Hackney Council's Code of Conduct applies to **all** Members of the Council, the Mayor and co-opted Members.

This note is intended to provide general guidance for Members on declaring interests. However, you may need to obtain specific advice on whether you have an interest in a particular matter. If you need advice, you can contact:

- The Corporate Director of Legal, HR and Regulatory Services;
- The Legal Adviser to the committee; or
- Governance Services.

If at all possible, you should try to identify any potential interest you may have before the meeting so that you and the person you ask for advice can fully consider all the circumstances before reaching a conclusion on what action you should take.

1. Do you have a disclosable pecuniary interest in any matter on the agenda or which is being considered at the meeting?

You will have a disclosable pecuniary interest in a matter if it:

i. relates to an interest that you have already registered in Parts A and C of the Register of Pecuniary Interests of you or your spouse/civil partner, or anyone living with you as if they were your spouse/civil partner;

ii. relates to an interest that should be registered in Parts A and C of the Register of Pecuniary Interests of your spouse/civil partner, or anyone living with you as if they were your spouse/civil partner, but you have not yet done so; or

iii. affects your well-being or financial position or that of your spouse/civil partner, or anyone living with you as if they were your spouse/civil partner.

2. If you have a disclosable pecuniary interest in an item on the agenda you must:

i. Declare the existence and nature of the interest (in relation to the relevant agenda item) as soon as it becomes apparent to you (subject to the rules regarding sensitive interests).

ii. You must leave the room when the item in which you have an interest is being discussed. You cannot stay in the meeting room or public gallery whilst discussion of the item takes place and you cannot vote on the matter. In addition, you must not seek to improperly influence the decision.

iii. If you have, however, obtained dispensation from the Monitoring Officer or Standards Committee you may remain in the room and participate in the meeting. If dispensation has been granted it will stipulate the extent of your involvement, such as whether you can only be present to make representations, provide evidence or whether you are able to fully participate and vote on the matter in which you have a pecuniary interest.

3. Do you have any other non-pecuniary interest on any matter on the agenda which is being considered at the meeting?

You will have 'other non-pecuniary interest' in a matter if:

i. It relates to an external body that you have been appointed to as a Member or in another capacity; or

ii. It relates to an organisation or individual which you have actively engaged in supporting.

4. If you have other non-pecuniary interest in an item on the agenda you must:

i. Declare the existence and nature of the interest (in relation to the relevant agenda item) as soon as it becomes apparent to you.

ii. You may remain in the room, participate in any discussion or vote provided that contractual, financial, consent, permission or licence matters are not under consideration relating to the item in which you have an interest.

iii. If you have an interest in a contractual, financial, consent, permission or licence matter under consideration, you must leave the room unless you have obtained a dispensation from the Monitoring Officer or Standards Committee. You cannot stay in the room or public gallery whilst discussion of the item takes place and you cannot vote on the matter. In addition, you must not seek to improperly influence the decision. Where members of the public are allowed to make representations, or to give evidence or answer questions about the matter you may, with the permission of the meeting, speak on a matter then leave the room. Once you have finished making your representation, you must leave the room whilst the matter is being discussed.

iv. If you have been granted dispensation, in accordance with the Council's dispensation procedure you may remain in the room. If dispensation has been granted it will stipulate the extent of your involvement, such as whether you can only be present to make representations, provide evidence or whether you are able to fully participate and vote on the matter in which you have a non pecuniary interest.

Further Information

Advice can be obtained from Yinka Owa, Director of Legal on 020 8356 6234 or email Yinka.Owa@hackney.gov.uk

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Hackney

MINUTES OF A MEETING OF THE PENSIONS COMMITTEE

MONDAY, 19TH SEPTEMBER, 2016

Councillors Present:	**Councillor Robert Chapman in the Chair**
	Cllr Kam Adams, Cllr Michael Desmond (Vice-Chair) and Cllr Geoff Taylor
Co-Optee	**Jonathan Malins- Smith**
Officers in Attendance:	Ian Williams (Group Director of Finance and Corporate Resources), Michael Honeysett (Director of Financial Management), Rachel Cowburn (Project Manager/Accountant) and Christopher Ellmore (Treasury and Banking Manager).
Also in Attendance:	Karen McWilliam & Jayne Deeble - Aon Andrew Johnson } Hymans Robertson Robbie McInroy } Claire Curtin - Trucost Plc Representatives of Divest Hackney

1 APOLOGIES FOR ABSENCE

1.1 Apologies for absence were received from Councillors Moule and Demirci and Stephen Rix.

1 DECLARATIONS OF INTEREST - MEMBERS TO DECLARE AS APPROPRIATE

2.1 Councillors Chapman, Desmond and Taylor declared a non-pecuniary interest as deferred members of the LGPS.

3 CONSIDERATION OF THE MINUTES OF THE PREVIOUS MEETING

3.1 **RESOLVED that the minutes of the previous meeting held on 27th June 2016 were a correct record.**

4 TRAINING - ACTUARIAL VALUATION

4.1 Rachel Cowburn introduced the training session on the 2016 actuarial valuation and the methodology employed to assist in meeting the standards set out in the CIPFA Knowledge and Skills Framework and in the Fund's training policy.

4.2 Robbie McInroy delivered a presentation on Active versus Passive Equity Investment and an outline of the areas covered are set out below:

2016 VALUATION TRAINING AND INITIAL WHOLE FUND RESULTS
Valuation basics

- How the Fund works
- Why do we do a valuation
- Valuing benefits for a single member
- Valuing all future benefit payments
- Liability valuation- assumptions
- Achieving the right balance
- Increased scrutiny
- 2016 valuation timeline

Valuation results

- Key assumptions
- Whole fund valuation results
- Why has the funding position changed
- Experience since 2013
- Membership data received and validated
- Membership experience
- Outlook for contributions
- Whole fund valuation results – SAB basis

Next steps

- Prepare and consult on Funding Strategy Statement
- Testing of Council contribution strategies
- Finalise valuation report

RESOLVED to note the contents of the report.

5 PENSION FUND ACTUARIAL VALUATION 2016 - INITIAL REPORT

5.1 Rachel Cowburn introduced the report providing a summary of the progress to date on the 2016 actuarial valuation.

5.2 In response to Councillor Adams questions regarding the frequency of the actuarial valuations and a review of the contribution rate, Mr McInroy stated that a valuation takes place every three years and any new contribution rate would be set in April 2017.

5.3 Councillor Taylor asked if the results of the European referendum had been factored into the valuation. Mr McInroy stated that the valuation had been undertaken in 2015 and therefore did not account of the referendum results.

5.4 Councillor Desmond asked whether any lessons could be learnt from the collapse of the BHS pension fund. Mr McInroy stressed that the public sector Pension Funds were taxpayer funded schemes and therefore more secure than private sector pensions.

5.5 Mr Malins- Smith enquired whether the devaluation of sterling had impacted on the Fund’s liabilities. Mr Johnson explained that the devaluation of sterling would impact on imports and exports and as a consequence on asset classes.

5.6 The Chair expressed concern at the impact of lower yields on the Fund. Ms Cowburn stated that work was being undertaken to improve the Fund's funding level.

RESOLVED to note the contents of the report.

6 UPDATE ON CLIMATE CHANGE RECOMMENDATIONS AND PRESENTATION OF CARBON FOOTPRINTING RESULTS

6.1 Rachel Cowburn introduced the report providing an update on the recommendations approved at the January 2016 Strategy meeting in relation to the Pension Fund's approach to investment in fossil fuels and provided an update on the work undertaken to date on each recommendation.

6.2 Claire Curtin, Trucost covered the following areas in her presentation on the Portfolio climate change carbon risk audit:

Portfolio climate change carbon risk audit

- Summary of holdings analysed
- Portfolio carbon footprints
- Attribution Analysis
- Disclosure analysis: Portfolio s & benchmarks
- Stock & sector effects: Aggregated Equity
- Top 10 contributors to Aggregate Equity holding Footprint
- Findings for Underlying Funds
- Exposure to Fossil Fuel Extractives in Portfolio
- Exposure to Coal Mining & Power in Portfolio
- Fossil Fuel embedded emissions in portfolio
- Top 10 Positions with Embedded Carbon
- Green- Brown Power exposure in portfolio
- Transitioning to a Low Carbon Economy
  Conclusion

6.3 Mr Malins- Smith enquired whether the London CIV was looking into passive and active investments and whether officers were satisfied to have active management alongside passive investments. Mr Honeysett confirmed that the Council was satisfied to have active together with passive investments. Ms Cowburn confirmed that the risk register would be updated to incorporate active investments as a risk.

.6.4 Councillor Desmond asked how the Council would ensure that the London CIV's investment approach was aligned with Hackney's strategy towards more ethical investments. Mr Williams stated that the Fund had set a clear strategy in relation to ethical investments and advised that the Chair and Hackney Officers were also members of London CIV boards.

6.5 Councillor Taylor asked if the Committee's statement of social responsibility including a reduction in fossil fuels was being applied by the Fund Managers. Ms Cowburn indicated that the Committee's Investment Strategy Statement had been highlighted to the Fund Managers during their review meetings.

6.6 A representative from Divest Hackney thanked the Committee members for their continuing work on reducing the carbon footprint and presented a petition of over 1,000 signatures in support of disinvesting from fossil fuels. It was argued that engagement was an ineffective tool in discouraging investments in fossil fuels. The Chair highlighted that disinvestment from fossil fuels could not be undertaken speedily as other factors had to be taken into consideration such as Members' fiduciary responsibility, the impact of legislation and other social considerations. Ms Cowburn stated that active managers had responded positively to engagement and this had impacted positively on Environmental, Social and Governance issues. The use of fossil fuels was a part of the UK economy and engagement would be necessary to encourage alternative investments in low carbon footprint.

6.7 Mr Honeysett advised that a report detailing a new investment strategy would be submitted at a forthcoming meeting in January 2017. Ms Cowburn indicated that officers were exploring the transfer of liquid investments to the London CIV and the Chair asked officers to consult with scheme members on this issue.

6.8 The Chair enquired in relation to affordable low carbon investment vehicles in the market. Mr Johnson said that the market for low carbon investments had grown significantly over the past 12 months and Ms Curtin stated that there were many low carbon indices with some having long track records.

6.9 Mr Malins- Smith asked whether Trucost was an international company. Ms Curtin stated that Trucost was a global company with teams based in Europe, USA, and Australia and that many international Pension Funds had encountered similar challenges as the UK Funds.

6.10 In response to questions from Members, Ms Curtin indicated that many listed companies had exposure to oil and coal and that a reduction in funding could discourage companies from investing in alternatives such as wind power to replace fossil fuels.

RESOLVED to note the report and the outcome of the carbon footprinting analysis as presented at the meeting

LGPS UPDATE - INVESTMENT POOLING AND GAD SECTION 13 REPORT

7.1 Christopher Ellmore introduced the report providing an update on the Government's pooling agenda for LGPS funds and the progress made by the London Collective Investment Vehicle. The report also provided information on the 'dry run' Section 13 analysis completed by the Government Actuary's Department (GAD) using the 2013 valuations and included a copy of GAD's S13 report and S13 briefing note from Hymans Robertson.

7.2 The Chair sought clarification regarding the issue causing the amber solvency measure for LBH fund at table 5. Mr Williams said that the emerging risk was a potential asset shock of +5%, which could impact on the solvency of the Fund.

7.3 Mr Malins- Smith asked about the LBH Fund maturity ranking based on a scale of 0-10 compared to the other 90 Funds. Mr Honeysett indicated that this information was not available at the meeting and that he would respond directly to Mr Malins –Smith. Ms McWilliam stressed that the amber and red solvency measures were useful as advance warnings of possible solvency risks to the Fund and to highlight areas for further investigation and if necessary for the Fund to review its approach.

RESOLVED to note the report

8 PENSION FUND ACTUARIAL VALUATION 2016 - INITIAL REPORT

8.1 Rachel Cowburn introduced the report detailing the role of the Pensions Committee and summarised the key activities and achievements in 2015/16 that demonstrated how the Committee has fulfilled its role effectively acting in its capacity as quasi-trustees of the Council's Pension Fund. It was noted that this report would be presented to full Council in 2016.

RESOLVED to note the report.

9 PENSION FUND ANNUAL REPORT AND ACCOUNTS 2015/16

9.1 Rachel Cowburn introduced the post audit annual report and accounts of the London Borough of Hackney Pension Fund for the year ended 31st March 2016. Michael Honeysett reported that the accounts has been finalised and no issues had been reported.

RESOLVED to:

1. **Approve the Pension Fund Annual Report and Accounts.**
2. **Approve publication and distribution to interested parties .**

RESOLVED to note the contents of the report.

10 PENSION FUND - QUARTERLY UPDATE

10.1 Christopher Ellmore introduced the update on the Pension Fund's key quarterly performance measures, including an update on the funding position, investment performance, engagement and corporate governance, budget monitoring, administration performance and reporting of breaches. Mr Ellmore advised as at there had been a reduction in the Fund's funding level to 66% at the end of June 2016 compared to 68% in March 2016.

10.2 It was noted that there had been a reported breach in August 2016 relating to the Annual Benefit Statements and failure to issue all active and deferred benefit statements by 31 August. In response to questions from Members relating to the breach, Ms Cowburn advised that the payroll provider was in the process of implementing a new payroll system and officers were liaising with the provider to ensure that the next statement was issued within the deadline.

10.3 The Chair noted the decline in the pension administrator's (Equinti) performance from the previous year. Ms Cowburn stated that the poor performance could be attributed to the manual work being undertaken on member records, which was due to the continued lack of an interface from the Council's payroll provider that was fit for purpose. This issue would be ongoing until the implementation of a contract with the new payroll provider.

RESOLVED to note the contents of the report.

11 THE PENSIONS REGULATOR CODE OF PRACTICE COMPLIANCE CHECKLIST

11.1 Rachel Cowburn introduced the report on the updated Pensions Regulator Code of Practice Compliance Checklist for the London Borough of Hackney Pension Fund. It was noted that the level of compliance had reduced from the previous year and this had been due to the member vacancies on the Pensions Board. Ms Cowburn summarised the areas of best practice that were partial or non-compliant and the further work necessary to ensure compliance.

RESOLVED to note the Code of Compliance Checklist and where further work is required and being undertaken.

12 REVIEW OF ADDITIONAL VOLUNTARY CONTRIBUTION ARRANGEMENTS

12.1 Rachel Cowburn introduced the report in relation to the review undertaken by Aon on the Additional Voluntary Contribution (AVC) arrangements held within the London Borough of Hackney Pension Fund.

12.2 Ms Deeble, Aon presented the findings of the review and summarised the recommendations as set out in the report.

12.3 Mr Malins- Smith sought clarification with regard to a member’s increase in AVC contributions that were not reflected in their account. Ms Deeble explained that the issue had arisen as a result of the Council’s payroll not implementing the contribution changes through its payroll system and this issue had resolved within a few months by July 2016. Ms McWilliam added that the delay in responding to the member enquiry could have been due to the recent changes to the pension regulations.

RESOLVED to:

1. **Note the London Borough of Hackney Pension Fund AVC Review .**
2. **Agree the recommendations to :**
   a. **review the structure of the lifestyle strategies available through the AVC arrangement**
   b. **close the Global Equity Fund to new members**
   c. **consider using some of the additional services available**
   d. **update the Fund's website**
   e. **investigate with employers in relation to the timing of monthly payments and the auctioning of requests to change AVCs.**

13 ANY OTHER BUSINESS WHICH IN THE OPINION OF THE CHAIR IS URGENT

13.1 PENSIONS BOARD ANNUAL REPORT

13.1.1 The supplementary paper was circulated at the meeting.

13.1.2 Rachel Cowburn introduced the report covering the LBH Pensions Board Annual Report. Ms Cowburn highlighted that three of the four representatives had become ineligible as they were no longer Council employees and the Council was currently undertaking a recruitment process to replace these representatives.

RESOLVED to note the contents of the report.

13.2 Mr Williams advised that the next special strategy meeting of the Pensions Committee would be scheduled in December 2016.

Duration of the meeting: 6.30-9.25pm

Contact:
Rabiya Khatun
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020 8356 6279

Hackney

REPORT OF THE GROUP DIRECTOR OF FINANCE & CORPORATE RESOURCES		
Pension Fund Actuarial Valuation 2016 Update and Asset Liability Modelling **Pensions Committee Strategy Meeting 6th December 2016**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **None**

1. INTRODUCTION

1.1 This report provides a summary of the progress on the 2016 Actuarial Valuation and whilst at the time of writing the report is not ready for distribution, an update from the Fund's Actuary Hymans Robertson will be provided at the meeting. It also provides information on the Asset Liability Modelling exercise currently underway, which will help to determine the Fund's approach to contribution rate setting over the 3 years from 1st April 2017. The Actuarial Valuation is undertaken every 3 years and is an assessment of the assets and liabilities of the pension fund, which determines the funding level.

2. RECOMMENDATION

2.1 **The Pensions Committee is recommended to:**

- **Note the report.**

3. RELATED DECISIONS

- Pensions Committee 18th November 2015 – Actuarial Valuation 2016 – Training and Preliminary Work
- Pensions Committee 18th November 2015 – Investment Strategy
- Pensions Committee meeting 19th September 2016 – Training Session provided to Committee
- Pensions Committee meeting 19th September 2016 – Actuarial Valuation 2016 – Initial Report

4. COMMENTS OF THE GROUP DIRECTOR OF FINANCE & CORPORATE RESOURCES

4.1 The experience of the Pension Fund in terms of its investments, its liabilities, both over the short and longer term, and the profile of its members between actuarial valuations determines its financial status, its funding level and the contributions required from employers for the following three years. With the Council as both the administering authority and the largest employer contributing to the Pension fund, the level of funding for the Pension Fund and the requirement to fund both past and current employee pension benefits can directly impact on the level of resources available for other Council services. The valuation outcome is sensitive to both the actuarial and financial assumptions made within the valuation; any significant variations to those assumptions could impact upon the Fund's financial position.

4.2 Members have been kept informed of the progress of the Funding position through the quarterly updates on the funding status. At the 2013 valuation the Fund was 70.1% funded, over a 3 year period the funding level has remained between 60% and 80%. Based on the new 2016 valuation assumptions the current 2016 valuation indicates a funding level of 77.0% and the actual financial deficit has decreased by around £56m during the period.

4.3 At the time of the 2013 valuation the common contribution rate for the Fund as a whole was 34.5%, the equivalent rate at the 2016 valuation for the Fund as a whole is 30.8%. The contribution rate currently paid by the Council is 36.9% of the payroll; this applies across the Council and its local authority schools.

4.4 The Pensions Committee's governance role means that they need to ensure that there are realistic strategies in place to meet funding goals and that strategies are affordable, prudent and provide stability for employers in the Fund. Understanding the impact of adopting different approaches to the investment strategy and the setting of employer contribution strategies enables the Committee to consider the longer term financial impact of such decisions and to take reasonable financial decisions when setting investment and contribution strategies. The costs of obtaining the advice are minimal in comparison to the benefits that could be derived from having an appropriate strategy in place with a 'flight plan' set out to achieve full funding.

5. COMMENTS OF THE DIRECTOR, LEGAL

5.1 The Local Government Pension Scheme (Administration) Regulations 2013, Regulation 62, requires an Administering Authority to obtain an actuarial valuation of its fund as at 31st March 2016 and every 3 years on 31st March thereafter. The documents obtained by the Administering Authority from the actuary must include: a valuation report and a rates and adjustment certificate.

5.2 Regulation 66 requires the Administering Authority to publish and supply copies of any valuation report and a contribution rates and adjustments certificate to the Secretary of State, each employing bodies contributing into the Fund and any other body liable to make payments to the Fund.

5.3 There are no immediate legal implications arising from this report.

6. VALUATION UPDATE

6.1 The Pension Fund is required to undertake a formal actuarial valuation every 3 years to establish the funding position of the Pension Fund and to set the contribution rate for the following three years. The regulatory background to the valuation is contained within the Local Government Pension Scheme (Administration) Regulations 2013. The last formal actuarial valuation of the London Borough of Hackney Pension Fund was carried out as at 31st March 2013, which showed an improvement in the funding level from 66% in 2010 to 70% in 2013 and the contribution rates set for each employer in the Fund for the three years commencing 1st April 2014.

6.2 Members were provided with an initial update at their meeting on the 19th September 2016 based on preliminary results from the valuation process. These indicated a funding level of 77% based on 2016 valuation assumptions. The funding level reflects a 17 year deficit recovery period reflecting the Fund's objective to meet its deficit within the medium to longer term timeframe.

Valuation Date	**31/03/2013 (£m)**	**31/03/2016 (£m)**
Past Service Liabilities		
Active Employees	403	424
Deferred Pensioners	382	441
Pensioners	575	658
Total Liabilities	**1,360**	**1522**
Net Assets	**954**	**1,172**
Surplus / (Deficit)	(406)	(350)
Funding Level %	**70.1%**	**77.0%**
Contribution Rates	**31/03/2013 (% of pay)**	**31/03/2016 (% of pay)**
Employer Future Service Rate (inc. expenses)	19.9%	20.7%
Past Service Adjustment (17 deficit recovery period)	14.6%	10.1%
Total Employer Contribution Rate (inc. expenses)	**34.5%**	**30.8%**

6.3 The funding level and contribution rates are set out in the table below with a comparison against the corresponding 2013 valuation figures:

6.4 The 2013 valuation funding level of 70.1% was based on the position of the Fund having assets of £954m and liabilities of £1,360m, i.e. for every £1 of liabilities the Fund has the equivalent of 70.1p of assets. Looking at the 2016 valuation, the table shows that this position is the equivalent of 77.0p of assets for every £1 of liabilities, also note the actual monetary deficit has decreased from £406m to £350m.

6.5 The net assets are an amalgamation of pension contributions paid in to the Fund by employers and employees and all the asset classes managed by external fund managers such as equities, bonds, property and multi asset. The total liabilities are a summation of all the pension payments which have been accrued up to the valuation date in respect of all active scheme members, pensioners and deferred members which will be paid over the remaining lifetime of all members; these could potentially stretch out beyond 60 years. The actuary uses a variety of assumptions to calculate the contribution rates required for the Fund to meet its liabilities in respect of both future service and any historic deficit.

6.6 As discussed at the September meeting of the Pensions Committee, some early modelling work was undertaken in advance of the formal valuation to look at the management of employer contribution rates due to commence on 1st April 2017. The outcome of this work, in conjunction with the Whole Fund results indicated that for the Council, continuing the contribution rates to 31st March 2017 as currently set out in the rates and adjustments certificate would allow for some reduction in contributions from 1st April 2017. The initial modelling exercise has now been updated using 2016 data, with the results due to be presented at the meeting.

6.7 Other individual employer rates are currently being assessed and will be discussed with employers as soon as is feasible. The triennial valuations adjust contribution rates that employers are required to pay to try to ensure that any deficit at end of contract is kept to a minimum; despite the improvement in the Whole Fund funding position, it is possible that some employers could face an increase in their individual employer contribution rates. Results will be made available as soon as possible and employers will be given the opportunity to meet with the Officers and Fund actuary to discuss their results should they wish to do so.

6.8 The actuary will be attending the meeting and will be available for further discussion of the valuation results.

7. ASSET LIABILITY MODELLING

7.1 As set out in Section 6.6, some early Asset Liability Modelling work was undertaken in advance of the formal valuation to look at the management of employer contribution rates due to commence on 1st April 2017. The modelling used 2013 valuation data to assess a variety of contribution, asset allocation and asset outperformance scenarios, assessing the probability of success and tail risks associated with each. These results were then used to provide an early indication of the appropriateness of the different scenarios.

7.2 The outcome of this work, in conjunction with the Whole Fund results indicated that for the Council, continuing the contribution rates to 31st March 2017 as currently set out in the rates and adjustments certificate would allow for some reduction in contributions from 1st April 2017. The initial modelling exercise has now been updated using 2016 data and the new asset outperformance assumption (1.65), with the results due to be presented at the meeting. These results will be used to help finalise contribution rates and inform the allocation to growth assets that will feed through into the investment strategy.

Ian Williams
Group Director of Finance & Corporate Resources

Report Originating Officers:	Rachel Cowburn	☎020-8356 2630
Financial considerations:	Michael Honeysett	☎020-8356 3332
Legal comments:	Stephen Rix	☎020-8356 6122

Hackney

REPORT OF THE GROUP DIRECTOR OF FINANCE AND CORPORATE RESOURCES		
Investment Strategy Development **Pensions Committee** **6TH December 2016**	**Classification** **Public** **Ward(s) affected** **ALL**	**Enclosures** **Three**

1. INTRODUCTION

1.1 This report provides the Committee with a discussion on long term investment strategy to be considered in the light of the actuarial valuation and modelling work to be presented at the Strategy Meeting, as well as the introduction of the new Investment Strategy statement from 1st April 2017. The report follows on from the training sessions provided to Members in June and September 2016, looking at equity investment strategies and progress on the 2016 valuation.

2. RECOMMENDATIONS

2.1 The Pensions Committee is recommended to:

- **Consider the options provided at the meeting**

3. RELATED DECISIONS

3.1 Pensions Committee 18th November 2015 – Actuarial Valuation 2016 – Training and Preliminary Work

3.2 Pensions Committee 18th November 2015 – Investment Strategy

3.2 Pensions Committee 27th June 2016 – Training Session – Active and Passive Investment Approaches

3.3 Pensions Committee 19TH September 2016 – Actuarial Valuation 2016 – Training and Initial Report

4 COMMENTS OF THE GROUP DIRECTOR, CORPORATE FINANCE AND RESOURCES

4.1 This presentation by the Fund's investment consultant will set out the timeline for and initial approach to the development of the investment strategy, with a focus on ensuring that the strategy is appropriate for the funding position of the Fund and reflects the investment beliefs of the Committee.

4.2 Understanding the impact of adopting different approaches to the investment strategy and the setting of employer contribution strategies enables the Committee to consider the longer term financial impact of such decisions and to take reasonable financial decisions when setting investment and contribution strategies. These decisions will have a significant long term impact on the Council, as the largest contributing employer in the Fund. The costs of obtaining the advice on this subject are minimal in comparison to the benefits that could be derived from having an appropriate strategy in place with a ‘flight plan’ set out to achieve full funding.

5. COMMENTS OF THE DIRECTOR, LEGAL

5.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1st November 2016. These Regulations represent an update to the LGPS (Management and Investment of Funds) Regulations 2009 and make a number of changes, including dispensing with the current, explicit limits on specified types of investment and instead charging administering authorities with determining the appropriate mix of investments for their funds. However, administering authorities must now adhere to official guidance; broad powers allow the Government to intervene if they do not.

5.2 Effective dates aside, no changes have been made to these regulations since their publication in draft form in 2015. Both regulations and guidance have been published with this report as Appendices 1 and 2 respectively.

5.3 Regulation 7 of the 2016 Regulations requires the Administering Authority to formulate an Investment Strategy Statement in line with the guidance published by the Secretary of State. The first such statement must be published by 1st April 2017; the work described in this paper is essential to ensure that the Authority is able to comply with these regulations.

6. DEVELOPMENT OF STRATEGY

6.1 With the initial results of the triennial valuation now available, the first step in the development of the investment strategy is to consider if the current investment and funding plan meets the Fund’s objectives, and if the level of investment risk could be altered to better meet those objectives without impacting long term funding requirements. One of the most significant decisions will be determining, through the valuation and asset liability modelling results, if the Fund’s current allocation to growth assets remains appropriate, or if it should be adjusted.

6.2 Having considered the ability of the Fund to be able to achieve its agreed objectives, and whether changes need to be made to the allocation to growth assets, it will then be appropriate to consider more specifically how the strategy should be framed and whether refinements to the current mandate structure are appropriate. Areas for consideration might include:

- What is an efficient balance of active and passive management?
- Should alternative return sources be considered, and could they improve the balance between risk and return?
- What is an appropriate strategy for the Bond Mandate, given current low gilt yields and tight credit spreads?
- How should the recommendations approved as part of the Fund’s climate change strategy meeting be implemented within the strategy to ensure that they are in line with the funding objectives?

6.3 Also planned as part of the development of the strategy is a review of the Fund’s current de-risking triggers, and whether or not they remain appropriate. The objective here is objective is not to remove all risk but to target a long term steady-state where contributions are maintained at an affordable level and an appropriate amount of investment risk is taken to generate the required level of returns.

6.4 The Fund's investment consultant with be in attendance at the meeting to help facilitate a discussion around the initial phase of strategy development and the Committee's investment beliefs

7. INVESTMENT STRATEGY STATEMENT

7.1 New regulations (The LGPS (Management and Investment of Funds) Regulations 2016) affecting LGPS funds in England and Wales came into force on 1st November 2016. The new Regulations will dispense with the current, explicit limits on specified types of investment and, instead, charge administering authorities with determining the appropriate mix of investments for their funds. The quid pro quo for more freedom in the formulation of investment strategies is an obligation upon administering authorities to adhere to official guidance and broad powers allowing the Government to intervene if they do not.

7.2 The Regulations come into force on 1 November 2016 but give administering authorities until 1 April 2017 to publish their first Investment Strategy Statement (ISS) in accordance with the new rules. The Department for Communities and Local Government (DCLG) had already, in September 2016, taken the rather unusual step of publishing its statutory guidance—before the Regulations became law. Effective dates aside, the legislation is all but identical to the draft version that was circulated for consultation purposes in November 2015.

7.3 Regulation 7 of the new Regulations sets out for Administering Authorities what must be included within the new ISS. Items to be included are as follows:

- a requirement to invest fund money in 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 the ways in which risks are to be assessed and managed;
- the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
- the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
- the authority's policy on the exercise of the rights (including voting rights) attaching to investments

A draft setting out the initial structure of Hackney's ISS is attached at Appendix 3 to this report. This will require significant revision as aspects of the investment strategy itself are updated and clarified; however, this initial draft has been included to provide the Committee with an overview of the structure. An updated draft of the ISS will be brought to the meeting in January.

7.4 The CIV's RI sub-group is due to meet shortly after the strategy meeting to discuss and draft customisable wording for funds with regards to the points on ESG considerations and exercise of voting rights. This will ensure that a pool level approach is included as appropriate, whilst allowing funds to include their own policies on Responsible Investment.

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STATUTORY INSTRUMENTS

2016 No. 946

PUBLIC SERVICE PENSIONS, ENGLAND AND WALES

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016

Made - - - -	*21st September 2016*
Laid before Parliament	*23rd September 2016*
Coming into force - -	*1st November 2016*

The Secretary of State makes these Regulations in exercise of the powers conferred by sections 1(1) and 3(1) to (4) of, and Schedule 3 to, the Public Service Pensions Act 2013(**a**).

In accordance with section 21(1) of that Act, the Secretary of State has consulted such persons and the representatives of such persons as appeared to the Secretary of State to be likely to be affected by these Regulations.

In accordance with section 3(5) of that Act, these Regulations are made with the consent of the Treasury.

Citation, commencement and extent

1.—(1) These Regulations may be cited as the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

(2) These Regulations come into force on 1st November 2016.

(3) These Regulations extend to England and Wales.

Interpretation

2.—(1) In these Regulations—

"the 2000 Act" means the Financial Services and Markets Act 2000(**b**);

"the 2013 Regulations" means the Local Government Pension Scheme Regulations 2013(**c**);

"the Transitional Regulations" means the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014(**d**);

"authority" means an administering authority listed in Part 1 of Schedule 3 to the 2013 Regulations;

"fund money" means money that is or should be in a pension fund maintained by an authority;

(**a**) 2013 c. 25; see section 2 of and Schedule 2 to that Act as to how the power is exercisable by the Secretary of State.
(**b**) 2000 c. 8.
(**c**) S.I. 2013/2356.
(**d**) S.I. 2014/525.

"proper advice" means the advice of a person whom the authority reasonably considers to be qualified by their ability in and practical experience of financial matters;

"the Scheme" means the scheme established by the 2013 Regulations.

(2) Any restrictions imposed by these Regulations apply to authorities which have the power within section 1 of the Localism Act 2011(**a**) (local authority's general power of competence) or section 5A(1) of the Fire and Rescue Services Act 2004(**b**) in the exercise of those powers.

(3) Any authority which does not have the powers mentioned in paragraph (2) has, by virtue of these Regulations the power to do anything authorised or required by these Regulations.

Investment

3.—(1) In these Regulations "investment" includes—

(a) a contract entered into in the course of dealing in financial futures, traded options or derivatives;

(b) a contribution to a limited partnership in an unquoted securities investment;

(c) a contract of insurance if it is a contract of a relevant class, and is entered into with a person within paragraph (2) for whom entering into the contract constitutes the carrying on of a regulated activity within the meaning of section 22 of the 2000 Act(**c**).

(2) The persons within this paragraph are—

(a) a person who has permission under Part 4A of the 2000 Act (permission to carry on regulated activities)(**d**) to effect or carry out contracts of insurance of a relevant class;

(b) an EEA firm of the kind mentioned in paragraph 5(d) of Schedule 3 to the 2000 Act (EEA passport rights), which has permission under paragraph 15 of that Schedule(**e**) to effect or carry out contracts of insurance of a relevant class; and

(c) a person who does not fall within sub-paragraph (a) or (b) whose head office is in an EEA state other than the United Kingdom, and who is permitted by the law of that state to effect or carry out contracts of insurance of a relevant class.

(3) A contract of insurance is of a relevant class for the purposes of paragraphs (1)(c) and (2) if it is—

(a) a contract of insurance on human life or a contract to pay an annuity on human life where the benefits are wholly or partly to be determined by reference to the value of, or income from, property of any description (whether or not specified in the contract) or by reference to fluctuations in, or an index of, the value of property of any description (whether or not so specified); or

(b) a contract to manage the investments of pension funds, whether or not combined with a contract of insurance covering either conservation of capital or payment of minimum interest.

(4) For the purposes of this regulation—

"limited partnership" has the meaning given in the Limited Partnerships Act 1907(**f**);

"recognised stock exchange" has the same meaning as in section 1005 of the Income Tax Act 2007(**g**);

"traded option" means an option quoted on a recognised stock exchange; and

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(**a**) 2011 c. 20.
(**b**) 2004 c. 21; section 5A was inserted by section 9(1) of the Localism Act 2011.
(**c**) Section 22 was amended by section 7(1) of the Financial Services Act 2012 (c. 21).
(**d**) Part 4A of the 2000 Act was inserted by section 11(2) of the Financial Services Act 2012.
(**e**) Paragraph 15 was amended by S.I. 2003/2066, 2007/3253, 2012/1906,2013/1881 and 2015/575.
(**f**) 1907 c. 24.
(**g**) 2007 c. 3; section 1005 was substituted by the Finance Act 2007 (c. 11) and amended by the Taxation (International and Other Provisions) Act 2010 (c. 8).

"unquoted securities investment partnership" means a partnership for investing in securities which are not quoted on a recognised stock exchange when the partnership buys them.

Management of a pension fund

4.—(1) An authority must credit to its pension fund(**a**), in addition to any sum otherwise required to be credited by virtue of the 2013 Regulations or the Transitional Regulations—

(a) the amounts payable by it or payable to it under regulations 15(3)(b), 67 and 68 of the 2013 Regulations (employer's contributions and further payments);

(b) all amounts received under regulation 69(1)(a) of the 2013 Regulations (member contributions);

(c) all income arising from investment of the fund; and

(d) all capital money deriving from such investment.

(2) In the case of an authority which maintains more than one pension fund, as respects sums which relate to specific members, the references in this regulation to the authority's pension fund is to the fund which is the appropriate fund(**b**) for the member in question in accordance with the 2013 Regulations.

(3) Interest under regulation 71 of the 2013 Regulations (interest on late payments by Scheme employers) must be credited to the pension fund to which the overdue payment is due.

(4) An authority must pay any benefits to which any person is entitled by virtue of the 2013 Regulations or the Transitional Regulations from its pension fund.

(5) Any costs, charges and expenses incurred administering a pension fund may be paid from it except for charges prescribed by regulations made under sections 23, 24 or 41 of the Welfare Reform and Pensions Act 1999(**c**) (charges in relation to pension sharing costs).

Restriction on power to borrow

5.—(1) Except as provided in this regulation, an authority must not borrow money where the borrowing is liable to be repaid out of its pension fund.

(2) Subject to paragraph (3), an authority may borrow by way of temporary loan or overdraft which is liable to be repaid out of its pension fund, any sums which it may require for the purpose of—

(a) paying benefits due under the Scheme; or

(b) to meet investment commitments arising from the implementation of a decision by it to change the balance between different types of investment.

(3) An authority may only borrow money under paragraph (2) if, at the time of the borrowing, the authority reasonably believes that the sum borrowed and interest charged in respect of that sum can be repaid out of its pension fund within 90 days of the borrowing.

Separate bank account

6.—(1) An authority must hold in a separate account kept by it with a deposit-taker all fund money.

(2) "Deposit-taker" for the purposes of paragraph (1) means—

(a) a person who has permission under Part 4A of the 2000 Act (permission to carry on regulated activities) to carry on the activities specified by article 5 of the Financial

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(**a**) An administering authority is required to maintain a pension fund by regulation 53(1) of, and paragraph 1 of Schedule 3 to the 2013 Regulations.

(**b**) See regulation 53(2) of and Part 2 of Schedule 3 to the 2013 Regulations for provisions relating to an administering authority becoming the "appropriate administering authority" in relation to a person.

(**c**) 1999 c. 30; see S.I. 2000/1047 and S.I. 2000/1049.

Services and Markets Act 2000 (Regulated Activities) Order 2001 (accepting deposits)(**a**);

(b) an EEA firm of the kind mentioned in paragraph 5(b)(**b**) of Schedule 3 to the 2000 Act (EEA passport rights) which has permission under paragraph 15 of that Schedule(**c**) to accept deposits;

(c) the Bank of England or the central bank of an EEA state other than the United Kingdom; or

(d) the National Savings Bank.

(3) An authority must secure that the deposit-taker may not exercise a right of set-off in relation to the account referred to in paragraph (1) in respect of any other account held by the authority or any party connected to the authority.

Investment strategy statement

7.—(1) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State.

(2) The authority's investment strategy must include—

(a) a requirement to invest fund money in a wide variety of investments;

(b) the authority's assessment of the suitability of particular investments and types of investments;

(c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;

(d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;

(e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and

(f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

(3) The authority's investment strategy must set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment.

(4) The authority's investment strategy may not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007(**d**).

(5) The authority must consult such persons as it considers appropriate as to the proposed contents of its investment strategy.

(6) The authority must publish a statement of its investment strategy formulated under paragraph (1) and the first such statement must be published no later than 1st April 2017.

(7) The authority must review and if necessary revise its investment strategy from time to time, and at least every 3 years, and publish a statement of any revisions.

(8) The authority must invest, in accordance with its investment strategy, any fund money that is not needed immediately to make payments from the fund.

(**a**) S.I. 2001/544; article 5 was amended by S.I. 2002/682.
(**b**) Sub-paragraph (b) of paragraph (5) was substituted by S.I. 2006/3211 and then further substituted by S.I. 2013/3115.
(**c**) Paragraph 15 has been amended by S.I. 2003/2066, S.I. 2007/3253, 2012/1906, 2013/1881 and 2015/575.
(**d**) 2007 c. 28; section 212 was amended by the Police Reform and Social Responsibility Act 2011 (c. 13) and there are prospective amendments made by the Local Audit and Accountability Act 2014 (c. 2).

Directions by the Secretary of State

8.—(1) This regulation applies in relation to an authority's investment functions under these Regulations and the 2013 Regulations if the Secretary of State is satisfied that the authority is failing to act in accordance with guidance issued under regulation 7(1).

(2) Where this regulation applies in relation to an authority the Secretary of State may make a direction requiring all or any of the following—

(a) that the authority make such changes to its investment strategy under regulation 7 as the Secretary of State considers appropriate, within such period of time as is specified in the direction;

(b) that the authority invest such assets or descriptions of assets as are specified in the direction in such manner as is specified in the direction;

(c) that the investment functions of the authority under these Regulations and under the 2013 Regulations be exercised by the Secretary of State or a person nominated by the Secretary of State for a period specified in the direction or for so long as the Secretary of State considers appropriate;

(d) that the authority comply with any instructions of the Secretary of State or the Secretary of State's nominee in relation to the exercise of its investment functions under these Regulations and the 2013 Regulations and provide such assistance as the Secretary of State or the Secretary of State's nominee may require for the purpose of exercising those functions.

(3) Before making a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must consult the authority concerned.

(4) In reaching a decision whether to issue a direction under this regulation, and as to the contents of any direction, the Secretary of State must have regard to such evidence of the manner in which the authority is discharging or proposes to discharge its investment functions as is reasonably available including—

(a) any report from an actuary appointed under section 13(4) of the Public Service Pensions Act 2013 (employer contributions in funded schemes) or by the authority under regulation 62 of the 2013 Regulations (actuarial valuations of pension funds);

(b) any report from the local pension board appointed by the authority or from the Local Government Pension Scheme Advisory Board(**a**);

(c) any representations made by the authority in response to the consultation under paragraph (3);

(d) any other evidence that the Secretary of State regards as relevant to whether the authority has been complying with these Regulations or acting in accordance with guidance issued under regulation 7(1).

(5) If the Secretary of State is of the opinion that additional information is required to enable a decision to be taken whether to issue a direction under this regulation, or as to what any direction should contain, the Secretary of State may carry out such inquiries as the Secretary of State considers appropriate to obtain that information.

(6) An authority must comply with any request from the Secretary of State intended to facilitate the obtaining of information under paragraph (5).

Investment managers

9.—(1) Instead of managing and investing fund money itself, an authority may appoint one or more investment managers to manage and invest fund money, or any part of such money, on its behalf.

(**a**) The Local Government Pension Scheme Advisory Board is established by regulation 110 of the 2013 Regulations (which was inserted by S.I. 2015/57).

(2) But the authority may only appoint an investment manager if the authority complies with paragraphs (3) and (4).

(3) The authority must reasonably believe that the investment manager's ability in and practical experience of financial matters make that investment manager suitably qualified to make investment decisions for it.

(4) The authority must take proper advice in relation to the appointment and the terms on which the appointment is made.

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

10. An authority to which section 11 of the Trustee Investments Act 1961(**a**) applies may invest, without any restriction as to quantity, in any investment made in accordance with a scheme under section 11(1) of that Act (which enables the Treasury to approve schemes for local authorities to invest in collectively).

Consequential amendments

11.—(1) The 2013 Regulations are amended as follows.

(2) For regulation 57(1)(i) (pension fund annual report) substitute—

"(i) the current version of the investment strategy under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016;".

(3) For regulation 58(4)(b) (funding strategy statement) substitute—

"(b) the current version of the investment strategy under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.".

(4) For regulation 69(2)(b) (payment by Scheme employers to administering authorities) substitute—

"(b) paragraph (1)(c) does not apply where the cost of the administration of the fund is paid out of the fund under regulation 4(5) (management of a pension fund) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.".

Revocations and transitional provision

12.—(1) The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009(**b**) and the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2013(**c**) are revoked.

(2) Regulations 11 (investment policy and investment of pension fund money), 12 (statement of investment principles), 14 (restrictions on investments), 15 (requirements for increased limits) of and Schedule 1 (table of limits on investments) to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 continue to have effect in relation to an authority until the date when that authority first publishes its investment strategy statement under regulation 7.

(3) For the period starting on 1st November 2016 and ending on whichever is the earlier of the date the authority publishes its investment strategy statement under regulation 7, or 31st March 2017, regulation 7 applies to an authority only to the extent necessary to enable that authority to formulate and publish its investment strategy statement.

(**a**) 1961 c. 62; section 11(1) was amended by the London Government Act 1963 (c. 4) and the Local Government Act 1985 (c. 51).
(**b**) S.I. 2009/3093.
(**c**) S.I. 2013/410.

We consent to the making of these Regulations

David Evennett
Guto Bebb
Two of the Lords Commissioners of Her Majesty's Treasury

Signed by authority of the Secretary of State for Communities and Local Government

Marcus Jones
Parliamentary Under Secretary of State
21st September 2016 Department for Communities and Local Government

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations make provision in relation to the management and investment of pension funds held by administering authorities required to maintain such funds by the Local Government Pension Scheme Regulations 2013.

Regulations 2 and 3 respectively contain definitions and make provision that the restrictions imposed by the regulations bind authorities which have the "power of general competence" in the exercise of that power.

Regulations 4, 5 and 6 respectively set out which payments must be made into and out of the pension fund, restrict powers of borrowing and require fund money to be in a separate account.

Regulations 7 and 8 respectively require authorities to publish an investment strategy in accordance with guidance issued by the Secretary of State and enable the Secretary of State to issue a direction to any authority which fails to comply with its statutory obligations as regards its pension fund or which fails to act in accordance with the guidance.

Regulations 9 and 10 respectively allow for the appointment of investment managers and investment in Treasury approved schemes.

Regulations 11 and 12 respectively make consequential amendments relating to the investment strategy published under regulation 7 and transitional provisions.

No impact assessment has been produced because it has no impact on business, charities or voluntary bodies and minimal impact on the public sector.

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Department for
Communities and
Local Government

Local Government Pension Scheme

Guidance on Preparing and Maintaining an Investment Strategy Statement

September 2016
Department for Communities and Local Government

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Foreword

This guidance has been prepared to assist administering authorities in the local government pension scheme in England and Wales with the formulation, publication and maintenance of their Investment Strategy Statement.

New investment regulationsto be introduced later this year will include a requirement for administering authorities to publish new Investment Strategy Statements by 1st April 2017 in accordance with the guidance set out below.

Administering authorities will be required to act in accordance with the provisions in this guidance when Regulation 7 of the Local Govenrment Pension Scheme (Management and Investment of Funds) Regulations 2016 comes into force.

Part 1

Introduction and background

This guidance has been prepared to assist administering authorities in the formulation, publication and maintenance of their Investment Strategy Statement required by Regulation 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. Unless otherwise stated, references to regulations are to the 2016 Regulations.

An administering authority's duty to prepare, maintain and review their Funding Strategy Statement under Regulation 58 of the Local Government Pension Scheme Regulations 2013 ("the 2013 Regulations") is unaffected.

Statutory background

Regulation 7(1) requires an administering authority to formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State.

The Investment Strategy Statement required by Regulation 7 must include:-

a) A requirement to invest money in a wide variety of investments;
b) The authority's assessment of the suitability of particular investments and types of investments;
c) The authority's approach to risk, including the ways in which risks are to be measured and managed;
d) The authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
e) The authority's policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and

f) The authority's policy on the exercise of rights (including voting rights) attaching to investments.

The Investment Strategy Statement must also set out the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment. This, in effect, replaces Schedule 1 to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ("the 2009 Regulations").

Under Regulation 7(6) and (7), the statements must be published by 1st April 2017 and then kept under review and revised from time to time and at least every three years. Under transitional arrangements, key elements of the 2009 Regulations relating to investment policies will continue in force until such time that the Investment Strategy Statement under Regulation 7 is published.

Directions by the Secretary of State

Regulation 8 enables the Secretary of State to issue a Direction if he is satisfied that an administering authority is failing to act in accordance with this guidance.

One of the main aims of the new investment regulations is to transfer investment decisions and their consideration more fully to administering authorities within a new prudential framework. Administering authorities will therefore be responsible for setting their policy on asset allocation, risk and diversity, amongst other things. In relaxing the regulatory framework for scheme investments, administering authorities will be expected to make their investment decisions within a prudential framework with less central prescription. It is important therefore that the regulations include a safeguard to ensure that this less prescriptive approach is used appropriately and in the best long term interests of scheme beneficiaries and taxpayers.

Where there is evidence to suggest that an authority is acting unreasonably, it may be appropriate for the Secretary of State to consider intervention, but only where this is justified and where the relevant parties have been consulted. Regulation 8 includes a number of safeguards, including full consultation with the relevant authority, to ensure that the proposed power is used appropriately, proportionately and only where justified by the evidence.

The Secretary of State's power of intervention does not interfere with the duty of elected members under general public law principles to make investment decisions in the best long-term interest of scheme beneficiaries and taxpayers.

The power of Direction can be used in all or any of the following ways:-

a) To require an administering authority to make changes to its investment strategy in a given timescale;
b) To require an administering authority to invest assets as specified in the Direction;
c) To transfer the investment functions of an administering authority to the Secretary of State or a person nominated by the Secretary of State; and

d) To require an administering authority to comply with any instructions from either the Secretary of State or the appointed person in circumstances when the investment function has been transferred.

Before issuing any Direction, the Secretary of State must consult the administering authority concerned and before reaching a decision, must have regard to all relevant evidence including reports under section 13(4) of the Public Service Pensions Act 2013; reports from the scheme advisory board or from the relevant local pension board and any representations made in response to the consultation with the relevant administering authority. The Secretary of State also has the power to commission any other evidence or additional information that is considered necessary.

General

Part 2 below sets out the guidance for authorities under each of the component parts of Regulation 7. The specific requirements under each heading are shown at the end of each sub section in a text box and in bold type. It is important to note, however, that these lists are not exclusive and that administering authorities are also required to comply with general public law principles and act within a prudential framework.

Part 2

Regulation 7(2) (a) - Investment of money in a wide variety of investments

A properly diversified portfolio of assets should include a range of asset classes to help reduce overall portfolio risk. If a single investment class is not performing well, performance should be balanced by other investments which are doing better at that time. A diversified portfolio also helps to reduce volatility.

For example, the range of asset classes could include UK and overseas equities of different sectors; bonds with varying maturity; alternative investment assets such as private equity, infrastructure and cash instruments.

However, this guidance does not purport to prescribe the specific asset classes over which fund monies must be diversified. This remains a decision for individual administering authorities to make. Administering authorities are expected to be able to demonstrate that those responsible for making investment decisions have taken and acted on proper advice and that diversification decisions have been taken in the best long term interest of scheme beneficiaries.

An administering authority must also be able to demonstrate that they review their diversification policy from time to time to ensure that their overall target return is not put at risk.

Summary of requirements

In formulating and maintaining their policy on diversification, administering authorities:-

- **Must take proper advice**

- **Must set out clearly the balance between different types of investments**
- **Must identify the risks associated with their overall investment strategy**
- **Must periodically review their policy to mitigate against any such risks**

Regulation 7(2)(b) - The suitability of particular investments and types of investments

The concept of suitability is a critical test for whether or not a particular investment should be made. Although individual investment classes will have varying degrees of suitability in the context of an authority's funding and investment strategies, the overall aim of the fund must be to consider suitability against the need to meet pension obligations as they fall due.

Assessing the suitability of different investment classes involves a number of factors including, for example, performance benchmarks, appetite for risk, policy on non-financial factors and perhaps most importantly, funding strategy.

What constitutes suitability is clearly a matter for individual administering authorities to consider and decide in the light of their own funding and investment strategies, but there is a clear expectation that the assessment should be broadly consistent across all administering authorities. Administering authorities must therefore take and act on proper advice in assessing the suitability of their investment portfolio and give full details of that assessment in their Investment Strategy Statement.

Summary of requirements

In formulating their policy on the suitability of particular investments and types of investments, administering authorities:-

- **Must take proper advice**
- **Should ensure that their policy on asset allocation is compatible with achieving their locally determined solvency target**
- **Must periodically review the suitability of their investment portfolio to ensure that returns, risk and volatility are all appropriately managed and are consistent with their overall investment strategy**

Regulation 7(2)(c) - The approach to risk, including the ways in which risks are to be measured and managed

The appetite of individual administering authorities for taking risk when making investment decisions can only be a matter for local consideration and determination, subject to the aim and purpose of a pension fund to maximise the returns from investment returns within reasonable risk parameters.

Some of the key risks that an administering authority needs to be aware include financial, demographic or regulatory risks. A detailed summary of the identification of all risks and counter-measures to mitigate against them is beyond the scope of this guidance, but administering authorities will continue to have regard to the requirement under Regulation

58 of the 2013 Regulations to have regard to the "Guidance on Preparing and Maintaining a Funding Strategy Statement" published by CIPFA, which includes a section on risk and the ways in which it can be measured and managed.

Summary of requirements

In formulating their policy on their approach to risk, administering authorities:-

- **Must take proper advice**
- **Should clearly state their appetite for risk**
- **Should be aware of the risks that may impact on their overall funding and investment strategies**
- **Should take measures to counter those risks**
- **Should periodically review the assumptions on which their investment strategy is based**
- **Should formulate contingency plans to limit the impact of risks that might materialise**

Regulation 7(2)(d) - The approach to pooling investments, including the use of collective investment vehicles and shared services

All authorities must commit to a suitable pool to achieve benefits of scale. Administering authorities must confirm their chosen investment pool meets the investment reform and criteria published in November 2015, or to the extent that it does not, that Government is content for it to continue.

Any change which results in failure to meet the criteria must be reported by the administering authority, and/or pool, to the Secretary of State and the Scheme Advisory Board.

Administering authorities should set out their approach to pooling and the proportion of assets that will be invested through the pool. This must include the structure and governance arrangements and the mechanisms by which the authority can hold the pool to account.

Where services are shared or jointly procured, the administering authority must set out the rationale underpinning this and the cost benefit of this, as opposed to pooling.

Administering authorities must provide a summary of assets to be held outside of the pool, and how this demonstrates value for money. The progress of asset transfers to the pool must be reported annually against implementation plans and submitted to the Scheme Advisory Board. Where it is possible that an asset could be pooled in the future, authorities must set a date for review and criteria that need to be met before the asset will be pooled.

Summary of requirements

In formulating and maintaining their approach to pooling investment, including the use of collective investment vehicles and shared services, an administering authority must:-

- **Confirm the pooling arrangements meet the criteria set out in the November 2015 investment reform and criteria guidance at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479925/criteria_and_guidance_for_investment_reform.pdf, or have been otherwise agreed by the Government**
- **Notify the Scheme Advisory Board and the Secretary of State of any changes which result in failure to meet the criteria**
- **Set out the proportion of assets that will be invested through pooling**
- **Set out the structure and governance arrangements of the pool and the mechanisms by which the authority can hold the pool to account**
- **Set out the services that will be shared or jointly procured**
- **Provide a summary of assets that the authority has determined are not suitable for investing through the pool along with its rationale for doing so, and how this demonstrates value for money;**
- **Regularly review any assets, and no less than every 3 years, that the authority has previously determined should be held outside of the pool, ensuring this continues to demonstrate value for money**
- **Submit an annual report on the progress of asset transfers to the Scheme Advisory Board**

Regulation 7(2)(e) - How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments

When making investment decisions, administering authorities must take proper advice and act prudently. In the context of the local government pension scheme, a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence. This approach is the standard that those responsible for making investment decisions must operate.

Although administering authorities are not subject to trust law, those responsible for making investment decisions must comply with general legal principles governing the administration of scheme investments. They must also act in accordance with ordinary public law principles, in particular, the ordinary public law of reasonableness. They risk challenge if a decision they make is so unreasonable that no person acting reasonably could have made it.
The law is generally clear that schemes should consider any factors that are 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.

However, the Government has made clear that using pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

Although schemes should make the pursuit of a financial return their predominant concern, they may also 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.

Investments that deliver social impact as well as a financial return are often described as "social investments". In some cases, the social impact is simply in addition to the financial return; for these investments the positive social impact will always be compatible with the prudent approach. In other cases, some part of the financial return may be forgone in order to generate the social impact. These investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund.

Summary of requirements

In formulating and maintaining their policy on social, environmental and corporate governance factors, an administering authority:-

- **Must take proper advice**
- **Should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors**
- **Must explain the extent to which non-financial factors will be taken into account in the selection, retention and realisation of investments**
- **Should not pursue policies that are contrary to UK foreign policy or UK defence policy**
- **Should explain their approach to social investments**

Regulation 7(2)(f) - The exercise of rights (including voting rights) attaching to investments

The long-term investment interests of administering authorities are enhanced by the highest standards of corporate governance and corporate responsibility amongst the companies in which they invest. Poor governance can negatively impact shareholder value.

Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure and corporate governance, including culture and remuneration. Engagement by administering authorities is purposeful and can identify problems through continuing dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.

Engagement enables administering authorities as long term shareholders to exert a positive influence on companies to promote strong governance, manage risk, increase accountability and drive improvements in the management of environmental, social and corporate governance issues.

Administering authorities are encouraged to consider the best way to engage with companies to promote their long-term success, either directly, in partnership with other investors or through their investment managers, and explain their policy on stewardship with reference to the Stewardship Code. Administering authorities should become Signatories to the Code and state how they implement the seven principles and guidance of the Code, which apply on a “comply or explain” basis.

Concern has been expressed in the past about the scope of Regulation 12(2)(g) of the 2009 Regulations which, in effect, allowed each administering authority to decide whether or not to adopt a policy on the exercise of the rights attaching to investments, including voting rights. To increase awareness and promote engagement, Regulation 7(2)(f) now requires every administering authority to formulate a policy that reflects their stewardship responsibilities.

Summary of requirements

In formulating their policy on the exercise of rights, administering authorities:-

- **Must give reasons in their Investment Strategy Statement for not adopting a policy of exercising rights, including voting rights, attaching to investments**
- **Should, where appropriate, explain their policy on stewardship with reference to the Stewardship Code**
- **Should strongly encourage their fund managers, if any, to vote their company shares in line with their policy under Regulation 7(2)(f)**
- **May wish to appoint an independent proxy voting agent to exercise their proxy voting and monitor the voting activity of the managers, if any, and for reports on voting activity to be submitted annually to the administering authority**
- **Should publish a report of voting activity as part of their pension fund annual report under Regulation 57 of the 2013 Regulations**

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

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