Annual Report of the Pensions Committee 2017-2018

ANNUAL REPORT OF THE PENSIONS COMMITTEE 2017/18

1. CHAIR'S INTRODUCTION – COUNCILLOR ROBERT CHAPMAN

1.1 The Pensions Committee has responsibility for the management of the Pension Fund acting as quasi-trustees on behalf of the Administering Authority, the London Borough of Hackney.

1.2 During the 2017/18 municipal year the Pensions Committee undertook an extensive work and training programme, and met 5 times during the year. The Committee carries with it a considerable responsibility to ensure that the Pension Fund, which was valued at £1,475m at 31 March 2018 and has over 22,900 scheme members, is managed in an efficient and effective way. The Committee has responsibility for all aspects of the Pension Fund including managing the investments, ensuring governance arrangements are appropriate and scheme members and employers are kept informed of key information.

1.3 2017/18 saw an improvement in the funding level to 80.5%, up from 77% at the 2016 valuation and 79% at 31st March 2017. The monetary value of the deficit has decreased overall since the valuation from £406m to £362m, but has increased from since March 2017 from £349m. The Fund remains strongly cash flow positive with contributions and transfers in outstripping benefits paid and transfers out by £24.7 million plus a further net inflow from investments of £15.7 million. This is an area in which the Pensions Committee maintains strong oversight given the maturity profile of the Fund and the ongoing austerity programme affecting public services. Active membership of the Fund remains stable for the present, helping to maintain the strong cash flow position.

1.4 The Fund has continued its collaborative work through the National LGPS Frameworks project, which continues to deliver efficiency savings for both the Hackney Fund and the wider LGPS. Having been a founder member of a number of previous frameworks, Hackney continued its involvement through use of both the Transition Management and Third Party Administration Frameworks.

1.5 Responsible Investment remained a key priority for the Committee during 2017/18, with a particular focus on understanding and managing the risks posed to the Fund by climate change. In January 2017, the Committee approved a target for the Fund to reduce its exposure to future fossil fuel emissions by 50% over 6 years, in line with the 2°C commitment in the Paris agreement, and considered a number of proposals to help deliver this. Those initial proposals have now been implemented, with a transition exercise commencing during Q4 2017/18 and assets moving in Q1 2018/19.

1.6 The Committee agrees a training programme each year to ensure that it is able to evidence it has met the requirements of the CIPFA Knowledge and Skills programme and is able to fulfil the governance role with which it is charged. The Committee takes this aspect extremely seriously and training forms a key part of the agenda for each meeting, along with Committee Members and officers attending additional external training on a regular basis.

1.7 Details on the work and training undertaken by Committee during the municipal year 2017/18 are set out in section 3 of this report. Section 4 provides an outline of the anticipated work for the forthcoming year.

2. COMMITTEE MEMBERSHIP AND ATTENDANCE

2.1 The following Councillors were members of the Committee during the 2017/18 municipal year –

Cllr Robert Chapman (Chair)
Cllr Michael Desmond (Vice Chair)
Cllr Kam Adams
Cllr Feryal Demirci
Cllr Patrick Moule
Cllr Geoffrey Taylor

In addition, Jonathan Malins-Smith is co-opted to the Committee as the Scheme Member Representative. The position of Employer Representative remained vacant during the year; however, a new representative is now being sought.

2.2 The table below outlines Members' attendance at Pensions Committee meetings during the 2017/18 municipal year and the training sessions at which members were in attendance. It is noted that Members have a large number of commitments, including other public meetings and ward commitments, and are therefore not always available to attend meetings of the Committee.

Committee Members Attendance 2017/18									
	25th April	27th June		11th September		4th December		29th March	
	Meeting	Meeting	Training	Meeting	Training	Meeting	Training	Meeting	Training
Cllr Robert Chapman (Chair)	P	P	P	P	P	P	P	P	P
Cllr Michael Desmond (Vice Chair)	P	P	P	P	P	P	P	P	P
Cllr Kam Adams	P	P	P	A	A	P	P	P	P
Cllr Feryal Demirci	P	P	P	P	P	P	P	A	A
Cllr Patrick Moule	P	P	P	P	P	A	A	P	P
Cllr Geoff Taylor	P	A	A	A	A	A	A	A	A
Co-Opted Members									
Jonathan Malins-Smith	P	P	P	P	P	P	P	P	P

P = Present
A = Absent

2.3 Three Members, Cllr Geoffrey Taylor, Cllr Feryal Demirci and Cllr Patrick Moule stepped down from the Committee at the end of the municipal year. We would like to thank them for all their hard work and commitment to the Pension Fund during a time of considerable upheaval for the LGPS and ongoing challenge for defined benefit pension funds more generally.

3. WORK UNDERTAKEN IN THE 2017/18 MUNICIPAL YEAR

3.1 The Pensions Committee has responsibility for the strategic management of the Pension Fund, which by the end of the financial year held £1.48bn worth of assets with 22,913 scheme members. The Committee is responsible for deciding the broad asset allocation of the Pension Fund along with its strategic direction and for ensuring the long term solvency of the Fund, i.e. the ability to pay the pensions of all past, present and future scheme members. The Committee has considered a wide range of issues and taken a number of key decisions affecting the Pension Fund. The work of the Committee has broadly fallen under the following categories during the Municipal Year:

3.2 Governance and Administration

3.2.1 Following on from the approval of the 2016 valuation in March 2017, the Fund has seen a further increase in its funding from 77% at the valuation date to 80.5% at 31 March 2018. The funding level has fluctuated over the period, reaching a high of 83.2% at 31 December 2017. Despite these fluctuations, it is pleasing to note the funding level continued to improve, particularly given the planned incremental reductions in the Council's contribution rate. The Council's contribution rate reduced from 36.9% in 2016/17 to 34.9% in 2017/18, with further reductions to 33% planned over the next two years.

3.2.2 Compliance with The Pension Regulator's Code of Practice has continued to feature on the Committee's agenda during 2017/18. Although following the Code itself is not a legal requirement, it sets out how the Regulator expects the requirements of the Public Sector Pensions Act 2013 should be met. The Regulator has the power to take action where the provisions of the Act are not being met, and will use the Code as a core reference document in deciding on the appropriate action to take. The Committee has considered whether the management of the LB Hackney Pension Fund meets the standards set out in the Code through use of a compliance checklist, and ensured that appropriate processes are being developed for the few areas in which the Fund has not yet achieved full compliance.

3.2.3 The Committee has continued to closely monitor the quality of membership data supplied to the Fund, in particular that supplied by the Council, the Fund's largest employer. The Council changed payroll provider in July 2017 and, whilst improvements are in progress, has struggled to provide adequate data since. Whilst this has led to ongoing significant challenges with regards to data provision; the Committee have monitored developments closely, whilst officers from the Fund have been closely involved with the development of reporting under the new contract. This work has continued into the new municipal year and is likely to continue over the medium term, as the Fund looks to improve ongoing processes ahead of the 2019 valuation.

3.2.4 At the start of the municipal year, the Committee reviewed the business plan for the year, setting out a timetable for both activities required to meet the Fund's objectives for the year and for the regular review of policy documents. The Business Plan also sets out draft Committee agendas for review to ensure that key items of business are dealt with at appropriate intervals.

3.3 Investments/Asset Allocation

3.3.1 2017/18 proved a generally positive year in investment terms, with strong performance seen in Qs 1-3 before dropping off significantly in Q4. The Fund ended the year valued at £1,475.3m, compared to £1,391m in 2016/17, an increase of 6.06%. 2017 saw strong growth and surprising stability against a backdrop of significant geo-political tensions. Monetary tightening, or the expectation thereof, had a significant impact on asset prices. The start of 2018, however, saw a significant increase in volatility as geopolitical factors came to the fore, resulting in sharp sell-offs in equity markets.

3.3.2 The Committee continued to monitor the investment portfolios and the performance of the Fund Managers it employs on a quarterly basis, as well as reviewing the rolling annual, 3yr and 5yr performance. 2017/18 resulted in modest gains for the Fund, which outperformed its customised benchmark with a return of 4.4%, relative to the benchmark return of 3.8%. Despite the volatility seen during Q4, the Fund has seen modest positive returns in absolute terms, whilst most asset classes outperformed their benchmark. The Fund's two strongest performers in absolute terms, EM equities and Property, were the only two mandates to underperform relative to their benchmark. The Fund did not introduce any new investment mandates during the year, but did make significant changes to its equity portfolio in Q1 2018/19.

3.3.3 In March 2017, the Committee agreed a new investment strategy for the Fund, with the aim of reducing the Fund's overall equity allocation and facilitating the pooling of assets. The Fund during 2017/18 set out to identify suitable strategies and providers and completed an equity transition exercise in Q1 of 2018/19. The transition reduced the Fund's exposure to UK equities with a move to BlackRock's MSCI Low Carbon Target index fund, and also established the Fund's first holding with the London CIV via the RBC Global Sustainable Equity Strategy. The changes were accompanied by other shifts in the fund's current active and passive equity portfolios to facilitate asset pooling, with a £145m UK passive allocation (FTSE Allshare) to be invested with BlackRock. The Fund has also made a £325m allocation to BlackRock's passive global equity fund (MSCI World).

3.4 LGPS Structural Reform and the London CIV

3.4.1 2017/18 has been another eventful year for the wider Local Government Pension Scheme (LGPS), particularly with regards to asset pooling. Like other London funds, Hackney chose to use the London CIV as its asset pool of choice; the CIV was already under development as a voluntary pooling platform. Over the period, the Pensions Committee has been broadly supportive of the CIV as a collaborative venture, and recognises the potential of pooling to increase the impact of the LGPS as a significant investor. Whilst the move to mandatory asset pooling exposed problems with the governance of the CIV during the year, the Fund has engaged constructively with the pool to try to develop solutions and commenced the process of transferring assets during Q1 of 2018/19.

3.4.2 The Fund's ISS sets out its medium term plans for moving its assets to the London CIV. With no common mandates with other London boroughs, the

Fund had no assets on the pool during the year; however, planning for a significant transition exercise commenced in Q4 2017/18, with assets being moved to the pool in Q1 2018/19 as detailed in Section 3.3.3.

3.4.3 Whilst decisions around manager selection are beginning to move to the London CIV, decisions on how the Fund will invest and in which investment strategies remains firmly with the Committee as the body responsible for the management of the Fund. The Committee is planning further changes to the Fund's investments for 2018/19 to bring the asset allocation in line with that set out in the ISS.

3.5 Responsible Investment

3.5.1 The Committee appreciates that it has responsibilities as a shareholder in the underlying companies that it holds in the portfolio and considerable time and discussion has taken place on ways to improve the Fund's stewardship arrangements. One issue particularly recognised is that of fossil fuels and their impact on climate change. The Committee has recognised that these issues could present systemic risks to the planet, but could also have a material impact on the financial position of the Pension Fund. It therefore has a long running work plan in place to ensure that this issue is addressed within the Fund's investment strategy.

3.5.2 In January 2017, the Committee approved a target for the Fund to reduce its exposure to future fossil fuel emissions by 50% over 6 years, in line with the 2^{o}C commitment in the Paris agreement, and considered a number of proposals to help deliver this. Those initial proposals have now been implemented; decisions to invest in the London CIV's global sustainable equity strategy and BlackRock's MSCI Low Carbon target index were made during 2017/18, with assets moving in Q1 2018/19. The Fund is now considering options to further reduce its exposure to fossil fuel reserves and make a positive contribution to the transition to a low carbon economy.

3.5.3 The Fund has reaffirmed its membership of the Local Authority Pension Fund Forum (LAPFF), which is a collection of Local Authority funds who by acting collectively are able to apply pressure to management of companies to try to improve their governance standards. The Committee is also planning a significant review of the Fund's Responsible Investment approach during 2018/19, to ensure that the Fund is able to push for effective outcomes within its new, pooled mandates.

3.6 Financial Monitoring including Annual Report and Accounts

3.6.1 At the Pensions Committee meeting on 11th September the Committee were presented with the 2016/17 Pension Fund Annual Report and Accounts for approval post- audit. The audit confirmed that there were no major issues with the accounts and that the auditors were satisfied with their findings.

3.6.2 The Committee reviewed and approved an updated Treasury Management Strategy for the Pension Fund at its meeting on 4th December 2017.

3.7 Other Collaborative Working

3.7.1 The Committee has been kept informed of the work that the Fund has been involved in on the National LGPS Frameworks for procurement, delivering efficiency savings both for the Fund itself and across the LGPS. The Fund has remained an active participant in the project during 2017/18, utilising both the Transition Management Framework via direct call off and the Third Party Administration Framework via mini-competition. Use of the frameworks has been of considerable benefit to the Fund, significant reducing procurement timelines for OJEU procurements and reducing the extent of legal work required.

3.8 Training

3.8.1 As part of the process of enabling Committee Members to fulfil their roles as quasi-trustees of the Pension Fund and the need to meet their fiduciary and regulatory responsibilities, the Committee were provided with a training session prior to each meeting. The CIPFA Knowledge and Skills Framework sets out in considerable detail the level of knowledge and skills that are expected of Committee Members who hold responsibility for the management of LGPS Funds; it is therefore vital to ensure that appropriate levels of training are available to Committee Members.

3.8.2 The topics covered in the training programme for Members were provided in line with the Knowledge and Skills Framework to help ensure that the Committee are able to achieve high levels of the specialist knowledge required of them.

3.8.3 The topics covered during the year in line with the Knowledge and Skills Framework are outlined in the table below:

Dedicated Training - Committee	Date
Longevity and Funding Risk (KSF 6)	27/06/2017
Accounting and Audit (KSF2)	11/09/2017
Transition and Risk Management (KSF4, KSF5)	04/12/2017
Investment Strategy – De-risking (KSF4, KSF5, KSF6)	21/03/2018
Supplemental Training - Committee	**Date**
Third Party Administration Procurement (KSF3)	29/04/2017
Passive Equity – Transition (KSF4, KSF5)	27/06/2017
Club Vita – Fund specific longevity (KSF6)	27/06/2017
TPR Code Compliance (KSF1)	11/09/2017
Pension Fund Report and Accounts (KSF2)	11/09/2017
MiFID II (KSF1, KSF5)	11/09/2017
London CIV Update (KSF1, KSF5)	04/12/2017
Pension Fund Risk Register (KSF1, KSF4, KSF6)	04/12/2017
Active and Passive equity – Transition update (KSF5, KSF6)	21/03/2018
Investment Strategy – De-risking framework (KSF4,	21/03/2018

KSF5, KSF6	

3.9 Ad-hoc Projects

3.9.1 The Committee also reviewed a number of other projects during the municipal year covering a range of topics as set out below:

- Pension Fund Risk Register – The Committee considered an updated Pension Fund Risk Register at its Committee meeting in January, ensuring a good understanding of the wider risks facing the Fund.
- Policy Reviews – Both the Communications Policy and the Pensions Administration Strategy were reviewed and approved by the Committee during the year as part of a rolling programme to ensure that policy documents are reviewed on a regular basis and any necessary changes are considered and approved.

4. WORK PROGAMME 2018/19

4.1 During the 2018/19 municipal year, the following reports are expected to be submitted to the Committee for consideration –

- Responsible Investment Review
- Report and Accounts 2018/19
- 2019/20 Budget
- Business Plan 2018/21
- London CIV Update
- Alternative Credit Options - Recommendation
- Update on progress of climate change resolutions
- Quarterly monitoring – covering Funding, Investment, Administration and Governance
- Membership data quality update/Data cleansing exercise
- GMP reconciliation exercise
- Regulatory changes and consultations
- Pension Fund Risk Register
- Training Programme
- Policy reviews, including administering authority discretions policies