APPENDIX 1

# Annual Report of the Pensions Committee 2018-2019

# ANNUAL REPORT OF THE PENSIONS COMMITTEE 2017/18

## 1. CHAIR'S INTRODUCTION – COUNCILLOR ROBERT CHAPMAN

1.1 The Pensions Committee is responsible for the management of the Pension Fund and acts on behalf of the London Borough of Hackney as the administering authority. We have responsibility for all aspects of managing the Pension Fund, including the Fund's investments, maintaining member records and ensuring that governance arrangements are appropriate. This is a considerable responsibility; the Pension Fund was valued at £1,575m at 31 March 2019 and has over 24,000 members.

1.2 2018/19 has been a busy year for the Hackney Pension Fund, with significant changes made to the Fund's investment portfolio during the year to help meet asset pooling and carbon reduction commitments. We have also introduced a new third party administration contract, and continued a significant program of work to improve member data ahead of the 2019 valuation.

1.3 The Fund remains strongly cash flow positive with contributions and transfers in outstripping benefits paid and transfers out by £24.0 million plus a further net inflow from investments of £12.3 million. This is an area in which the Pensions Committee maintains strong oversight given the maturity profile of the Fund and the ongoing restrictions on local government funding.

1.4 We have seen considerable fluctuation in the funding level over the year, driven not only by volatility in asset values but also by rising liability values as a result of changes in inflation and gilt yields. Since the Committee approved the 2016 valuation in March 2017, the Fund has seen a slight decrease in its funding from 77% at the valuation date to 76.5% at 31 March 2019.

1.5 Responsible Investment remained a key priority for the Committee during 2018/19, with a particular focus on understanding and managing the risks posed to the Fund by climate change. In 2017, the Hackney Pension Fund committed to reducing its exposure to fossil fuel reserves by 50%, reducing the Fund's exposure to carbon risk and aligning it with the 2 degrees scenario set out in the Paris Agreement. During 2018/19 we made significant changes to our equity portfolio to help meet this target, making substantial investments in two different strategies aimed at reducing our carbon exposure. We are currently carrying out a full refreshed carbon footprinting exercise in order that the Committee can fully understand the actual Impact these changes have had to date on reaching its stated target

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 2018/19 are set out in section 3 of this report. Section 4 provides an outline of the anticipated work for the forthcoming year.

1.8 I would like to take this opportunity of expressing my personal appreciation for the hard work and commitment to the Hackney Pension Fund that the rest of my Committee Members have put in, given the considerable challenges that we face in managing a £1.58 billion pension fund during a period of considerable upheaval for both the LGPS and the wider economy. I would also like to thank the hard work put in by our specialist advisors, the Group Director of Finance and Corporate Resources and his staff over the past year.

## 2. COMMITTEE MEMBERSHIP AND ATTENDANCE

2.1 The following Councillors were members of the Committee during the 2018/19 municipal year –

Cllr Robert Chapman (Chair)
Cllr Michael Desmond (Vice Chair)
Cllr Kam Adams
Cllr Rebecca Rennison
Cllr Polly Billington
Cllr Ben Hayhurst

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 2018/19 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 2018/19 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 23rd July | | 12th September | | 12th December | | 29th March | |
| | Meeting | Training | Meeting | Training | Meeting | Training | Meeting | Training |
| Cllr Robert Chapman (Chair) | P | P | P | P | P | P | P | P |
| Cllr Michael Desmond (Vice Chair) | P | P | P | P | P | P | P | P |
| Cllr Kam Adams | P | P | P | P | P | P | P | P |
| Cllr Polly Billington | P | P | P | P | P | P | A | A |
| Cllr Rebecca Rennison | P | P | P | P | P | P | P | P |
| Cllr Ben Hayhurst | P | P | A | A | P | P | P | P |
| | | | | | | | | |
| **Co-Opted Members** | | | | | | | | |
| Jonathan Malins-Smith | P | P | P | P | P | P | P | P |

| |
|---|
| P = Present |
| A = Absent |

2.3 Three Members, Cllr Polly Billington, Cllr Rebecca Rennison and Cllr Ben Hayhurst joined the Committee at the start of the municipal year. We would like to welcome them to the Committee and thank them for investing their time in this important and challenging area of work for the Council.

## 3. WORK UNDERTAKEN DURING 2018/19

3.1 The Pensions Committee has responsibility for the strategic management of the Pension Fund, which by the end of the financial year held £1.58bn worth of assets with 24,122 scheme members. We are 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. During the year, we have 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 year:

### 3.2 Governance and Administration

3.2.1 We have seen considerable fluctuation in the funding level over the year, driven not only by volatility in asset values but also by rising liability values as a result of changes in inflation and gilt yields. Since the Committee approved the 2016 valuation in March 2017, the Fund has seen a slight decrease in its funding from 77% at the valuation date to 76.5% at 31 March 2019. The funding level has fluctuated considerably over the year, with the primary cause of the decrease in funding level being falling gilt yields during the year. In line with the outcome of the last triennial valuation, the Council’s overall employer contribution rate reduced from 34.9% in 2017/18 to 34.0% in 2018/19, with a further reduction to 33% planned for 2019/20.

3.2.2 Compliance with The Pension Regulator’s Code of Practice has continued to feature on our 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 to be met. The Regulator has the power to take action if the requirements of the Act are not met and uses the Code to help decide what action to take. As part of our responsibility for the governance of the Fund, we use a compliance checklist to help monitor whether or not the Fund is meeting the required standards. We reviewed this checklist in detail in September 2018, and requested additional work in the few areas in which the Fund has not yet achieved full compliance.

3.2.3 In recent years, the Fund has experienced significant issues with the quality of membership data supplied by its employers and particularly that supplied by the Council, the Fund’s largest employer. The Council has experienced difficulties with data provision since the introduction of the new Local Government Pension Scheme (LGPS) in 2014. It changed payroll provider in July 2017 and, whilst improvements are in progress, has struggled to provide adequate data since. We have monitored this situation closely for some time, particularly as the Fund was required to make a further report to the Pensions Regulator concerning late issuance of Annual Benefits Statements (ABSs) to members for 2018. Given the long-standing nature of its data problems, the Fund has entered into a formal engagement with the Pensions Regulator regarding its data quality and the issuance of ABSs for 2019.

3.2.4 During the year, we have monitored officers' progress in working with both the Council and Equiniti, the Fund administrator, to develop new processes for data provision. A new format for the provision of year end data is now in place, and significant progress has been made in developing an automated interface process to provide data on a monthly basis. Although work is not yet complete, we are pleased to note that significant progress has been made, both in terms of the timeliness and accuracy of data provision and the relationship between the Council's payroll and ICT teams and the Pension Fund. This progress can be seen in the significant improvement in the number of ABSs for active members issued on time. In 2018, only 627 statements were issued by the deadline; for 2019, this had increased to over 5000 statements.

3.2.5 The administration team have implemented a new contract with Equiniti, our third party administrator, during the year, which offers significant improvements to the Fund's administration service. The improvements include a full update to member communications and scheme guides, an updated and improved employer guide and a new fund website. Further improvements to our online presence are planned for the future, including online member and employer self-service.

3.2.6 At the start of the municipal year, we 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 2018/19 has been a volatile year in investment markets; political uncertainty, escalating tensions between the US and China and uncertainty over Brexit all affected investor sentiment. The Fund experienced modest gains of 5.7% during the year, underperforming against its customised benchmark, which returned 7.2%. The key driver of this underperformance was the Fund's allocation to diversified growth funds, which returned -2.6%. The Fund's strongest performer in absolute terms was its equity allocation, which returned 6.4% overall. We introduced a number of new investment mandates during the year, making significant changes to the equity portfolio and adding an allocation to private debt.

3.3.2 We completed a significant equity transition exercise during Q1 2018/19, in line with the changes set out in our Investment Strategy Statement. The transition reduced the Fund's exposure to UK equities with a move to BlackRock's MSCI Low Carbon Target index fund (£150m), and also established our first holding with the London CIV via the RBC Global Sustainable Equity Strategy (£195m). The changes were accompanied by other shifts in the fund's current active and passive equity portfolios to facilitate asset pooling, with a £150m UK passive allocation (FTSE Allshare) to be invested with BlackRock. The Fund also made a £325m allocation to BlackRock's passive global equity fund (MSCI World).

3.3.3 In addition to the restructure of the equity portfolio, we have made a significant allocation to private debt during the year, with mandates of £95m and £65m awarded to Permira and Churchill respectively. These will be funded from the Fund's passive global equity allocation, over a period of approximately 2 years. More details on how the change in our asset allocation impacts the Fund's carbon reduction target can be found in the Responsible Investment section (section 3.5)

## 3.4 LGPS Structural Reform and the London CIV

3.4.1 Asset pooling is now firmly underway across the LGPS, with all 8 assets pools in England and Wales now operational. Decisions around manager selection are now moving to asset pools where suitable strategies are available; however, investment strategy decisions remain firmly with individual funds. Asset allocation and investment strategy decisions for the Hackney Pension Fund are therefore still made by the Pensions Committee as the body responsible for the management of the Fund.

3.4.2 The Fund's Investment Strategy Statement 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 moved to the pool automatically. During Q1 2018/19, we established our first mandate with the London CIV, investing via the Global Sustainable Equity fund managed by RBC. We have also invested in 3 passive equity funds managed by BlackRock, which, whilst they sit outside of the London CIV's investment platform, are considered by Government to be pooled.

3.4.3 The gradual move from voluntary to mandatory asset pooling for LGPS funds exposed a number of issues with the Governance of the London CIV. These were reviewed during 2017/18 and a number of recommendations were made. Following this review, it was decided that the CIV's original governance body, the Pensions CIV Sectoral Joint Committee, should be dissolved and replaced by a smaller Shareholder Committee.

3.4.4 The new Committee was established in July 2018 and is made up of 8 Local Authority Pension Committee Chairs and 4 Local Authority Treasurers. The Chair of the Board of London CIV is also a member of the Committee. Cllr Robert Chapman, Chair of the Hackney Pensions Committee, and Ian Williams, S151 officer for Hackney, have both been selected to sit on the Shareholder Committee.

3.4.5 The move to mandatory asset pooling has created a number of challenges for both LGPS funds and asset pools themselves. We have been generally supportive of the move to asset pooling; we have looked to maintain a positive relationship with the London CIV whilst challenging where appropriate to ensure that the CIV acts in the interests of its client funds and helps us to deliver our strategic investment requirements.

## 3.5 Responsible Investment

3.5.1 As a Committee, we take very seriously the Fund's responsibilities as a shareholder in the companies that it holds, 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. We recognise that these issues present systemic risks to the planet, but could also have a material impact on the financial position of the Pension Fund. We therefore have a long running work plan in place to ensure that this issue is addressed within the Fund's investment strategy.

3.5.2 In 2017, we committed to reducing the Fund's exposure to fossil fuel reserves by 50%, reducing the Fund's exposure to carbon risk and aligning it with the 2 degrees scenario set out in the Paris Agreement. During 2018/19 we made significant changes to our equity portfolio to help meet this target, making substantial investments in two different strategies aimed at reducing our carbon exposure.

3.5.3 Firstly, we have invested 10% (approx. £150m) of the Fund's assets in Blackrock's MSCI Low Carbon Target Fund, to help reduce our exposure to fossil fuels and carbon emissions while maintaining exposure to a wide range of global markets. The allocation has been funded by reducing exposure to the FTSE Allshare Index, which represented the Funds most significant exposure to fossil fuel companies. We have also invested £195m in RBC GAM's Global Sustainable Equity strategy via the London CIV, which invests in companies with long term, sustainable revenues, with a strong focus on Environmental, Social and Governance (ESG) factors.

3.5.4 In addition to the restructure of the equity portfolio, we have made a significant allocation to private debt during the year, with mandates of £95m and £65m awarded to Permira and Churchill respectively. This move to private debt will result in a shift from holding cap listed equities to lending to mid-sized companies. Whilst the new strategies do not specifically exclude all fossil fuel exposure, the nature and size of the companies involved means the Pension Fund will be reducing its exposure to large multinational fossil fuel companies. The move will therefore help the Fund lower its exposure to fossil fuel reserves, as set out in the Fund's carbon reduction target.

3.5.5 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 improve their governance standards. Cllr Rob Chapman, the Chair of the Pensions Committee, now sits as part of the LAPFF executive.

3.5.6 During the year, we commenced a review of the Fund's Responsible Investment approach, helping to ensure that the Fund is able to push for effective outcomes within its new, pooled mandates. To start this work, we have focused on engagement with the London CIV to help the pool company develop its approach to stewardship. We have seen an increase in the profile of Responsible Investment at the London CIV during the year and hope to see continued progress during 2019/20.

### 3.6 Financial Monitoring including Annual Report and Accounts

3.6.1 At the Pensions Committee meeting on 12th September the Committee were presented with the 2017/18 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 12th December 2018.

## 3.8 Training

3.8.1 To enable Committee Members 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 the Committee.

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 the level of 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 |
|---|---|
| Introduction to Fund Governance (KSF 1) | 23/07/2018 |
| Investment Strategy/Alternative Credit (KSF4, KSF5) | 12/09/2018 |
| Responsible Investment (KSF4, KSF5) | 12/12/2018 |
| Scheme liabilities and member longevity (KSF6) | 26/03/2019 |
| **Supplemental Training - Committee** | **Date** |
| Equity Restructure - Post Completion Report (KSF4, KSF5) | 23/07/2018 |
| London CIV Update (KSF1, KSF5) | 23/07/2018 |
| TPR Code Compliance (KSF1) | 12/09/2018 |
| Pension Fund Report and Accounts (KSF2) | 12/09/2018 |

| | |
|---|---|
| Alternative Credit - Strategy Decision (KSF4, KSF5) | 12/12/2018 |
| Pension Fund Risk Register (KSF1, KSF4, KSF6) | 12/12/2018 |
| Actuarial Valuation – Introduction (KSF6) | 26/03/2019 |
| Dedicated Training - Additional | Date |
| Private Debt - In depth product training | 31/10/2018 |

**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 December, ensuring a good understanding of the wider risks facing the Fund. Following advice from the Pension Board, the Fund made changes to the structure of the risk register to focus on key strategic and changing risks and to present information more clearly

- 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 PROGRAMME 2019/20

4.1 During the 2019/20 municipal year, the following reports are expected to be submitted to the Committee for consideration –

- Report and Accounts 2018/19
- 2020/21 Budget
- Business Plan 2019/22
- London CIV Update
- Actuarial Valuation report & Funding Strategy Statement
- Strategic Asset/liability review
- Infrastructure Investment
- Quarterly monitoring – covering Funding, Investment, Governance, Administration
- Membership data quality update/
- GMP reconciliation exercise
- Regulatory changes and consultations
- Pension Fund Risk Register
- Training Programme
- Policy reviews