Northumberland County Council

MEETING OF THE PENSION FUND PANEL

4 SEPTEMBER 2017

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

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1. Northumberland County Council Pension Fund draft Annual Report and Accounts for 2016/2017

Purpose of the report

The purpose of this report is to present the Northumberland County Council Pension Fund draft Annual Report and Accounts for the year to 31 March 2017 to the Panel.

Recommendation

The Panel is requested to accept the report.

Key issues

1.1 The Northumberland County Council Pension Fund (NCCPF) Annual Report and Accounts forms part of the Northumberland County Council Financial Statements, reflecting the legal status of the Fund as part of NCC. The LGPS Regulations also require a separate Annual Report and Accounts for the Pension Fund. The separate *draft* Annual Report for NCCPF for the year to 31 March 2017 has been **enclosed with these papers**.

1.2 NCC's Audit Committee is responsible for approving NCC's Financial Statements. Approval of the final, audited Pension Fund Annual Report will be sought at the 27 September 2017 NCC Audit Committee meeting. Audit Committee reviewed NCC's 2016/2017 draft Financial Statements in July 2017.

1.3 The points to note from the 2016/2017 Pension Fund accounts are:

- the Fund was £7 million net new money negative in 2016/2017 (compared to £10 million in 2015/2016), which represents a small reversal of the trend seen in recent years of cash outflows from dealings with members as the Fund matures; and
- the increase in Fund value during 2016/2017 reflects the high positive returns experienced by funds generally over that period with sterling depreciation being a strong driver of the positive performance in non-sterling assets, and follows the negative returns experienced during 2015/2016.

Some presentational changes will be made to the 2016/2017 draft Pension Fund accounts before finalisation at the end of September 2017. These changes are set out in paragraph 1.35 of this report.

1. Northumberland County Council Pension Fund draft Annual Report and Accounts for 2016/2017

BACKGROUND

1.4 A copy of the **draft** Pension Fund Annual Report and Accounts for the year to 31 March 2017 is **enclosed with these papers**. The final version of the Annual Report will be sent to all of the employers participating in the Fund and other interested parties. The final version will not be brought back to the Panel *unless there are significant changes* to the enclosed draft (other than changes to the Auditor's Statement), but it will be made available upon request. Members should note that the Independent Auditor's Statement will be inserted on pages 77 and 78).

1.5 As explained in the introduction to the enclosed Annual Report the total market value of the Fund, net of liabilities, has increased from £1,055 million to £1,308 million over the year to 31 March 2017. This increase in value reflects the fact that payments made from the Fund have been less than the annual return on the Fund (comprising income and realised and unrealised gains and losses on investments) together with receipts to the Fund in the year, due to a high positive Fund return of **24.2%.**

1.6 Members' attention is drawn particularly to **pages 79 and 80** of the Annual Report, which show the financial position for the Fund as a whole. The Fund Account, on page 79, shows all of the receipts to and payments from the Pension Fund in the year.

1.7 The aggregate net ***withdrawal*** from dealings with members shown in the enclosed draft accounts was £7 million in 2016/2017 (£10 million in 2015/2016). Prior to 2016/2017, withdrawals from dealings with members had been increasing, year on year, reflecting the increasing number of pensioners and the fact that the increasing contributions from active members are not matching the increasing value of benefit payments, as the Fund **matures**.

1.8 The reduction (from £10 million to £7 million) in the net withdrawal from dealings with members does *not* represent a change to the trend caused by increasing Fund maturity; the reduction reflects an increase in transfer values received into the Fund and a decrease in transfer values paid out of the Fund during 2016/2017 compared to the prior year.

1.9 Members should note that there will be a change to the presentation of the draft Fund Account before the Annual Report for 2016/2017 is finalised, and this is described in paragraph 1.35 below.

1.10 As in prior years, Northumberland County Council Pension Fund's Annual Report and Accounts have been prepared as a stand-alone document as well as forming part of Northumberland County Council's main Annual Financial Statements. There is a legal requirement to prepare a separate Annual Report for the Fund and the County Council's external auditors, Ernst & Young LLP (trading as EY), are required to express a separate "consistent with" audit opinion on the Fund accounts.

1.11 Note that the requirement to prepare a separate Annual Report and Accounts for the Fund and to have a separate audit opinion does not reflect any change in the legal status of the Pension Fund. Legally, the Pension Fund is part of Northumberland County Council; it is not a separate legal entity.

1.12 The Northumberland County Council Audit Committee will be requested to approve the final audited Accounts for Northumberland County Council and for Northumberland County Council Pension Fund at its meeting which is scheduled for 27 September 2017.

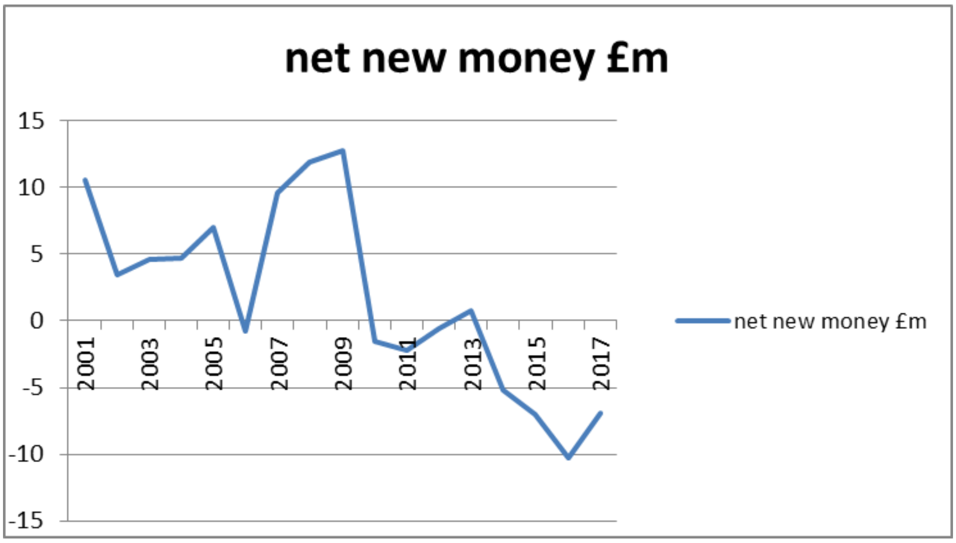
1.13 The LGPS Regulations require the separate Annual Report for the year ended 31 March 2017 to be published before 1 December 2017. The final signed version of the Annual Report will be posted to the NCC website after it has been signed at the September Audit Committee, to ensure this deadline is met.

Items of note from the accounts - ***continuing Fund maturity***

1.14 The Fund continues to **mature**. In this context, fund maturity means the proportion of active to non-active liabilities, and the greater the proportion of non-active liabilities, the more mature is the Fund. From the actuarial valuations of the Fund, liabilities (valued on a low risk basis) have gone from:

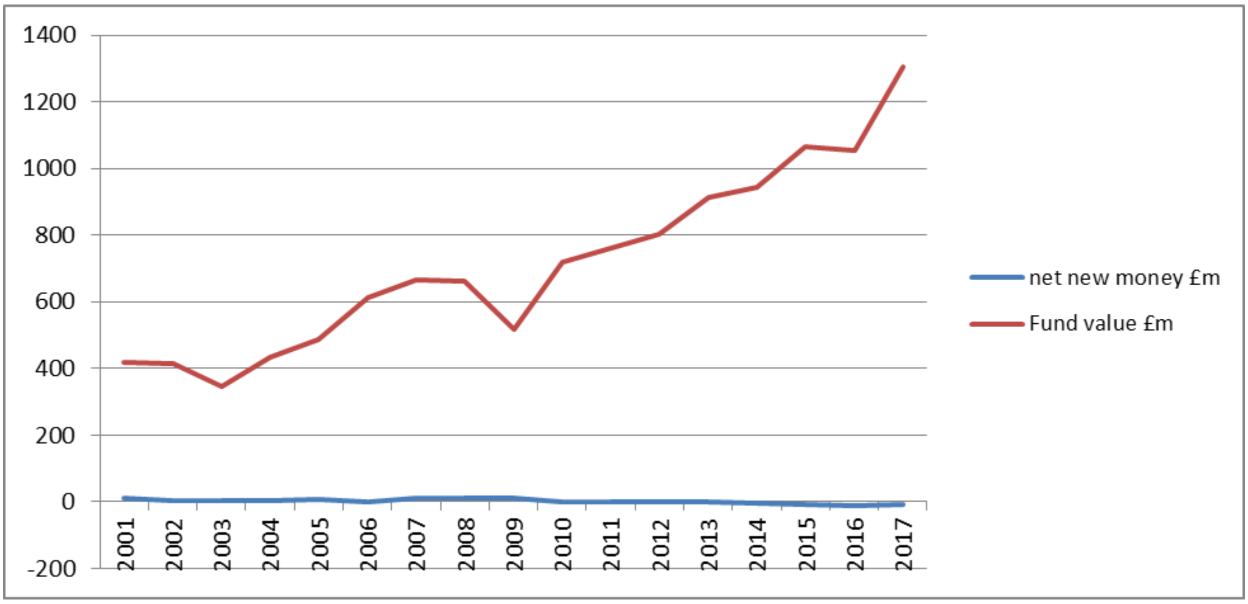
51% actives : 49% non-actives as at 31 March 2004; to
50% actives : 50% non-actives as at 31 March 2007; to
45% actives : 55% non-actives as at 31 March 2010; to
40% actives : 60% non-actives as at 31 March 2013; to
38% actives : 62% non-actives as at 31 March 2016.

1.15 One sign of the Fund maturing which can be seen in the Fund Account is the Fund becoming net new money negative (where cash flow negative means, broadly, that the Fund is paying more out for pensions than it is receiving in from employee and employer contributions). The graph below shows the net new money inflows or outflows to the Fund since 2000/2001:



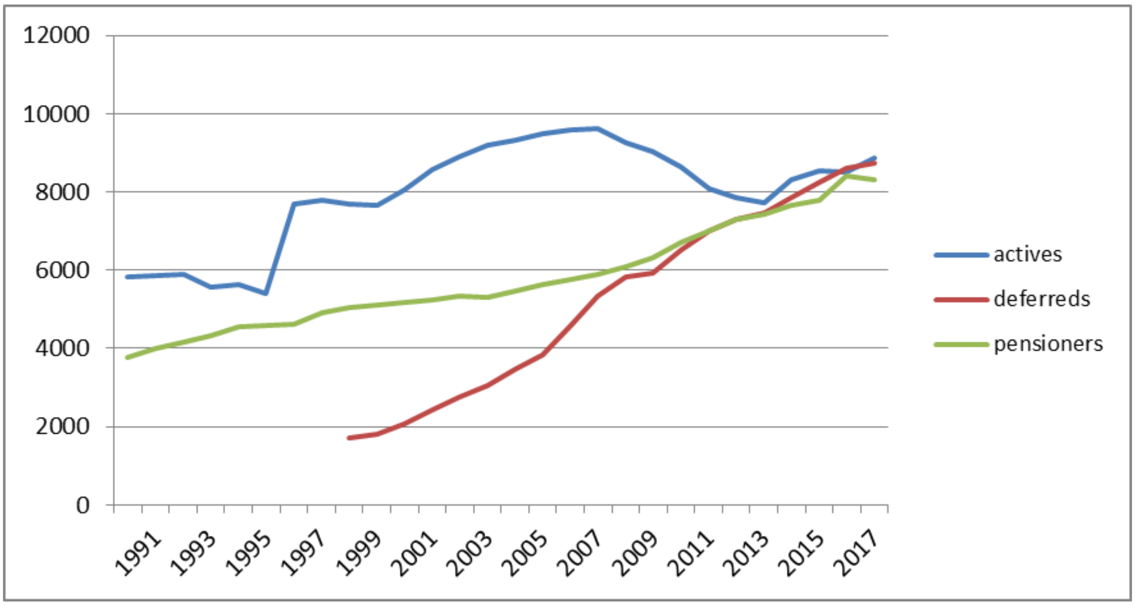
{The dip in 2006 is due to a one-off £9.7 million group transfer re Northumberland Care Trust staff.}

1.16 The decrease in net new money from 2009 reflects the reduction in staffing numbers before and after LGR in Northumberland. In the context of the increasing value of the Fund, cash outflows are not (yet) significant in terms of requiring Fund assets to be realised.



1.17 One other sign of the Fund maturing is the increase in the number of pensioners and deferred pensioners. The graph below shows the numbers of pensioner members, deferred pensioner members and active members at each year end since 1990 for the Fund as a whole. The upward trend in pensioner and deferred pensioner numbers is consistent since 1990. The upward trend in active member numbers reversed in 2007 for the first time in the Fund's history, and the steady decline in the number of actives after that reflected reductions in payroll expenditure for Fund employers, particularly for NCC.

1.18 The "uptick" in active member numbers from 2014 was due to the **effect of auto-enrolment** legislation, which has increased the *number* of active members. The increase in number of actives in 2013/2014 was not accompanied by an increase in payroll *value* (and employee/employer contributions to the Fund) because auto-enrolment brought mainly low-paid staff into the Scheme; however, it was accompanied by an increase in payroll in 2014/2015.



{The large increase in actives 1996 is due to a change in LGPS regulations which allowed certain part-timers to join the Scheme.}

1.19 Northumberland County Council's auto-enrolment staging date was **1 March 2013**, and its first three yearly re-enrolment date was 1 March 2016. The LGPS nationally has a relatively high opt out rate compared to other public sector schemes, with opt out rates estimated to be as high as one third of the potential membership. The majority of optants-out are lower paid, part-time employees, so estimates of the financial implications on employer pension contributions have assumed the maximum likely increase to be around 20%. NCC opted to apply ***transitional delay*** arrangements, which in effect postponed the date on which all previously opted out staff must be bought into the LGPS until **30 September 2017**. Auto-enrolment still applies to new employees taken on after the staging date, and to those who cross the auto-enrolment thresholds, i.e. attain age 22, and/or start earning more than £10,000*, so it has had an impact on the number of LGPS active members, but a further, (probably greater) impact might be expected in 2017/2018. In 2013, when transitional delay was granted, NCC had over 600 potential LGPS members who would be brought into the Scheme for the first time at the end of the transitional delay period.

* the earnings trigger of £10,000 applies in 2017/2018 and has been frozen since 2014/2015

1.20 Increasing fund maturity, for a funded scheme such as the LGPS, in theory should not *in itself* be a concern. The NCC Pension Fund can trace its origins back to the 1937 Superannuation Act when it became mandatory to maintain a fund for full time officers, and at the outset it only had active member liabilities. In the years since then, the non-active members' liabilities have steadily and slowly increased, as active members leave and retire. Therefore the Fund has matured, ***but*** because the Scheme is open to new members, maturing has been very slow in the past as departing active members are mainly replaced by new active members.

1.21 The LGPS has been in existence in periods of increasing numbers of active members and increasing payroll. For the NCC Pension Fund, the increasing payroll trend reversed in 2008, with the advent of LGR. Payroll for the Fund as a whole has reduced each year since then. Increasing Fund maturity would be *expected* given the current "age" of the Local Government Pension Scheme, and since the whole purpose of having a fund is to have assets available to pay the pension promises that have already been made when they fall due, it follows that fund maturity ought not to be a concern.

1.22 However, increasing maturity ***is*** a concern when a fund is significantly under-funded. The **shortfall** in assets compared to liabilities (i.e. the deficit) can ***only*** be **collected based on the active membership** of the Fund. In other words, as a fund matures the shortfall is being collected based on a shrinking payroll, and the contributions set to collect deficit, expressed as a percentage of payroll, goes up if payroll falls.

1.23 The trend of increasing maturity is being observed across the whole of the LGPS.

Items of note from the accounts - ***impact of the new LGPS***

1.24 The 2016/2017 accounts show the third year's impact of:

- the new LGPS (effective from April 2014); and
- the revised employer contributions payable following the 2013 actuarial valuation of the Fund.

The expectation was that both of these would lead to an increase in the contributions received by the Fund in 2014/2015, 2015/2016 and 2016/2017 compared to the prior year (2013/2014).

1.25 Information about the career average LGPS which came into effect from 1 April 2014 ("the LGPS 2014") can be found at: http://lgps2014.org/. From April 2014, employee contributions payable have been based on a new contributions banding table, with the rate of contributions paid by active members based on actual pensionable pay including overtime. This contrasts with the pre-2014 LGPS, where contributions were based on full time equivalent pay excluding non-contractual overtime.

1.26 The intention was that the average yield from employee contributions in the new Scheme ***nationally*** would increase from approximately 6.3% in the previous LGPS to **6.5%** in the LGPS 2014. The pre-2014 LGPS had seven different contribution band rates between 5.5% and 7.5% of pensionable pay, whereas the LGPS 2014 has nine different contribution band rates between 5.5% and 12.5%. The intention of the design of the LGPS 2014 was that some of the low paid members would pay lower contributions in the LGPS 2014 than they had before, and higher paid members would pay more, but the average employee contributions would be higher at around 6.5%. In particular, part-time employees might expect to pay less in the LGPS 2014 than before.

1.27 Individual employers and individual LGPS funds have their own average yield from employ**ee** contributions, based on their working patterns and pay scales. Employ**er** contribution rates payable are set for each individual employer, so these rates too are unique to each employer and to each fund. To some extent at least, those employers with a lower average employee contribution yield might expect to have a higher employer contribution rate than average.

1.28 From the information available, it would appear that for NCC Pension Fund as a whole, the **average yield** from **employee contributions** has **not increased** as a result of implementation of LGPS 2014.

1.29 The fact that the yield is less than the *nationally* expected average of 6.5% indicates that the average pay of NCC Pension Fund active members is lower than the LGPS national average. It is also possible that NCC Pension Fund has a relatively high proportion of part-time employees, whose contribution rates have reduced since April 2014.

1.30 One of the stated aims of the design of the LGPS 2014 was to increase the proportion of the cost of providing pensions borne by employees, so as to decrease the proportion borne by employers.

1.31 If the experience of NCC pension fund is typical of other LGPS funds in England and Wales, and the employee contribution yield has not increased for the average fund, then this will have a bearing on the implementation of the LGPS cost cap mechanism.

Other documents contained in the Annual Report

1.32 The Pension Fund Annual Report and Accounts includes **key documents**, as required by the LGPS Regulations, including:
- the Investment Strategy Statement [page 6];
- the Funding Strategy Statement [page 22];
- the Fund Account (i.e. the equivalent of an income and expenditure account) [page 79];
- the Net Assets Statement (i.e. the equivalent of a balance sheet, but without the pension liabilities) [page 80]; and
- a statement showing the actuarial value of the Pension Fund at the last actuarial valuation of the Fund (31 March 2013) restated for accounts purposes i.e. "Whole of Pension Fund Disclosures under IAS26" [page 105].

1.33 The Report shows [on page 108] total Pension Fund assets of £1,055.3 million and liabilities restated for accounts purposes of £1,421.4 million as at 31 March 2016, giving a **funding ratio of 74%** (71% as at 31 March 2013)

1.34 Northumberland County Council (as employer) participates in the Northumberland County Council Pension Fund, together with 38 other employers. Northumberland County Council is the biggest participating employer, with **approximately 85%** (86% as at 31 March 2016) of the Fund's membership.

Changes to be made to the 2016/2017 draft Accounts

1.35 During the course of the 2016/2017 audit work, the following presentational changes to 2016/2017 draft Accounts were requested by the EY auditors:
- administrative expenses and investment management expenses, which are shown separately in the draft Accounts, will be amalgamated into a single figure, described as "management expenses", and two notes to the accounts amalgamated into a single note;
- additional disclosures about remuneration of key management personnel will be included in the related party transactions note to the accounts;
- additional narrative will be added to the draft Accounts regarding the:
  - disclosure of actuarial position and assumptions,
  - basis of preparation, and
  - detailed descriptions of the Fair Value hierarchy;
- comparative information will be added to the significant holdings note to the accounts;
- a reconciliation will be added to the financial instruments note to the accounts of sales and purchases of level 3 investments in 2016/2017; and
- the audit fee of £22,516 will be shown separately within the notes.

These changes are in accordance with recent CIPFA recommendations.

1.36 The requested changes will be incorporated prior to finalisation of the 2016/2017 NCC Pension Fund Accounts.

NCC's Audit Committee review of the 2016/2017 draft Financial Statements

1.37 NCC's Audit Committee reviewed NCC's 2016/2017 draft Financial Statements (incorporating the NCC Pension Fund accounts) on 27 July 2017. There was a comment from the Audit Committee that NCC's Financial Statements are lengthy and therefore difficult for the reader to interpret, and a request to remove any superfluous information or shorten information included, where possible. Audit Committee has asked that the 2017/2018 Financial Statements be prepared with this comment in mind.

1.38 The approach taken by officers to the preparation of the NCC Pension Fund Financial Statements (i.e. pages 79 to end of the enclosed Annual Report) has been to include the *minimum disclosure information* only, in an attempt to retain clarity for the reader of the accounts. The CIPFA/LASAAC Code of Practice on Local Authority Accounting requirements have tended to only increase disclosure requirements, year on year, in the last decade or so.

MEETING OF THE PENSION FUND PANEL

4 SEPTEMBER 2017

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

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2. External Audit of Northumberland County Council Pension Fund 2016/2017 Accounts

Purpose of the report

The purpose of this report is to provide information to the Panel about the external auditors' draft Audit Results Report (i.e. the audit findings) which is enclosed with these papers.

Recommendation

The Panel is requested to accept the report.

Key issues

2.1 Claire Mellons (Manager) of Ernst & Young LLP (trading as EY), the Council's external auditors, will attend this meeting of the Pension Fund Panel to present EY's Final Report on the 2016/2017 Northumberland County Council Pension Fund Annual Report and Accounts.

2.2 EY, the external auditor, prepared a <u>Planning Report</u> for the Pension Fund audit which was reported to the Northumberland County Council Audit Committee in July 2017 and to the Pension Fund Panel at the 7 July 2017 meeting.

2.3 EY has now prepared the *draft* <u>Audit Results Report</u> (also known as an ISA 260) on the Pension Fund audit findings. The final report is **enclosed with these papers**. Claire Mellons will attend this meeting to present it to the Panel, and EY will also present it to the Audit Committee meeting scheduled for 27 September 2017.

2.4 Approval of the final version of the Pension Fund Annual Report and Accounts will be sought at the 27 September 2016 Audit Committee meeting, and Alison Elsdon (in her capacity as Section 151 Officer for NCC) will sign the annual "Management Representations Letter" the text of which is set out as Appendix C in the Audit Results Report.

MEETING OF THE PENSION FUND PANEL

4 SEPTEMBER 2017

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

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3. Conflicts of Interest Policy for NCC Pension Fund and individual declarations of interests

Purpose of the report

This report provides the Fund's Conflicts of Interest Policy which applies to Pension Fund Panel and Local Pension Board members and key officers involved in administering the LGPS, and requests that new Panel members complete a declaration of interests, and existing Panel and Board members review their current individual declarations.

Recommendation

Each Panel and Board member is requested to:

- **(i)** **review and note the Conflicts of Interest Policy as set out in Appendix 1 to this report;**
- **(ii)** ***either* review his/her own existing declaration and update if necessary, *or* (for new Panel members) agree and sign an individual declaration of interests; and**
- **(iii)** **review the Fund's Register of Conflicts of Interest which will be made available at this meeting.**

Key issues

3.1 To comply with the LGPS Advisory Board (SAB) guidance, a **Conflicts of Interest Policy** for NCC Pension Fund was adopted in May 2015. The Policy is attached as **Appendix 1** to this report and applies to:

- Pension Fund Panel members;
- Local Pension Board Members; and
- the supporting officers involved in the administration of the LGPS.

Adopting a formal policy of this type is intended to **demonstrate** compliance with the Pensions Regulator (tPR) and SAB guidance.

3.2 A Register of Conflicts of Interest is maintained by the Principal Accountant (Pensions), and all members of the Pension Fund Panel, the Local Pension Board and key officers are asked to complete or update an individual declaration of interests, annually. The individual declarations are retained in the Register.

3.3 The Fund's Register of Conflicts of Interest may be viewed by any interested party at any point in time, and is reviewed by the Panel on an annual basis. The Conflicts of Interest Policy will be reviewed every three years or sooner if necessary, with the first three-yearly review due in May 2018.

3. Conflicts of Interest Policy for NCC Pension Fund and individual declarations of interests

BACKGROUND

Scheme Advisory Board Guidance on the Local Pension Board

3.4 The LGPS (Amendment) (Governance) Regulations 2015 which established the Local Pension Boards within the LGPS were laid before Parliament in January 2015, and the (then Shadow) LGPS Advisory Board (SAB) immediately published its final "*Guidance on the creation and operation of Local Pension Boards in England and Wales"*. The Guidance (a 75 page document) can be accessed from the link:
http://www.lgpsboard.org/images/Guidance/LGPS_Board_Guidance_FINAL_PUBLISHED.pdf.

3.5 To comply with the Public Service Pensions Act 2013, the LGPS Governance Regulations 2015, the Pensions Regulator's (tPR) Code of Practice for Public Service Schemes, and the SAB guidance, NCC as administering authority for the NCC Pension Fund adopted a conflicts policy in May 2015.

3.6 The SAB guidance contains the following **comments** in relation to Local Pension Boards' conflicts policy (see chapter 7 of the guidance):

- *When establishing its Local Pension Board, the Administering Authority should prepare and approve a conflicts policy for the Board to adopt. The conflicts policy should cover the points discussed in the preceding paragraphs relating to the identification, monitoring and management of potential conflicts of interest (including adviser conflicts). Once adopted, the Local Pension Board should keep this policy under regular review.*
- *The conflicts policy should include as a minimum:*
  - *examples of scenarios giving rise to conflicts of interest;*
  - *how a conflict might arise specifically in relation to a member of a Local Pension Board; and*
  - *the process to be followed by members of a Local Pension Board and the Administering Authority to address a situation where members are subject to a potential or actual conflict of interest.*

3.7 The SAB guidance contains the following **action points** in relation to Local Pension Boards' conflicts policy:

- *An Administering Authority should prepare a code of conduct and a conflicts policy for its Local Pension Board for approval in accordance with the Administering Authority's constitution and at the first meeting of the Local Pension Board. The Local Pension Board should keep these under regular review.*
- *Training should be arranged for officers and members of a Local Pension Board on conduct and conflicts.*
- *A Local Pension Board should establish and maintain a register of interests for its members.*

3.8 NCC LGPS Pension Fund's **Conflicts of Interest Policy,** adopted in May 2015, is attached as **Appendix 1** to this report. Members should note that whilst the SAB guidance relates to Board members only, most administering authorities (including NCC) have taken the approach that standards which apply to the Board must also apply to the decision makers, i.e. the pensions committee. Also, it is implicit within the tPR Code of Practice that conflicts for Panel members and key officers are *at least as* relevant to the robust governance of the LGPS as conflicts for Local Pension Board members.

3.9 Therefore, NCC Pension Fund's Conflicts Policy applies to:

- Pension Fund Panel members;
- Local Pension Board Members; and
- supporting officers involved in the administration of the LGPS.

3.10 The Conflicts of Interest Policy itself will be reviewed every three years or sooner if necessary.

Register of Conflicts of Interest

3.11 The Policy refers to the maintenance of a Register of Conflicts of Interests. All current members of the Board, and the two members of the Panel who were Panel members in 2015 (i.e. Councillors Watson and Bawn) have already signed an individual declaration of interests. Such declarations should be updated annually or more often if required, and the annual review has taken place in September since the Policy was adopted, so a review is now due.

3.12 For the Panel members who were appointed following the May 2017 local elections (who were not members of the Panel in 2015), an individual declaration of interests should now be drafted and signed. An example of an individual declaration of interests is shown on **page 14** of Appendix 1.

3.13 Some standard suggested wording to be included in the individual declaration, appropriate to an elected member, is shown in **Appendix 2** to this report.

3.14 Members and officers should consider their other interests in Scheme employers and in potential Scheme employers (such as parish councils and governorships or directorships of schools or academies) when deciding on appropriate wording for their individual declarations. An up to date list (as at 31 March 2017) of the Fund's Scheme employers is shown on **pages 101 and 102** of the enclosed NCCPF 2016/2017 Report and Accounts.

3.15 The Fund's Conflicts Policy and Register operates **in addition to** the existing member/officer codes of conduct, because it is looking for conflicts that might not be also picked up as pecuniary interests. Also, having a separate, specific Policy and a Pension Fund Register of Conflicts of Interest ensures transparency and consistency across all of the groups covered.

3.16 Craig Johnson will contact members by email before this Panel meeting to ask each Panel and Board member to either:

- consider and review his/her own existing declaration, which he will provide, and update it if necessary; or
- (for new Panel members) consider appropriate wording and agree/sign an individual declaration of interests.

3.17 Panel members are asked to consider any conflicts that might apply to them individually and, if necessary, discuss them with Clare Gorman, Craig Johnson or NCC's Monitoring Officer, before completing the individual declaration.

<u>Monitoring and reporting</u>

3.18 The Conflicts Policy states:

"*The Fund's Register of Conflicts of Interest may be viewed by any interested party at any point in time. It will be made available by the Principal Accountant (Pensions) on request.*

In order to identify whether the objectives of this Policy are being met the Administering Authority will review the Fund's Register of Conflicts of Interest on an annual basis and consider whether there has been any potential or actual conflicts of interest that were not declared at the earliest opportunity."

3.19 A line could be added to the Annual Report of the Pension Fund Panel which is taken to full Council in May each year, to summarise how conflicts have been dealt with through the year, and whether, in the Chair of the Panel's view, the objectives of the Conflicts of Interests Policy have been met.

3.20 Panel members are asked to review the Register of Conflicts of Interest at this meeting.

MEETING OF THE PENSION FUND PANEL

4 SEPTEMBER 2017

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

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4. Recent actions taken by the Pensions Regulator

Purpose of the report

The purpose of this report is to provide information to the Panel regarding recent actions taken by the Pensions Regulator to ensure pension schemes are compliant with their legal obligations.

Recommendation

The Panel is requested to accept the report.

Key issues

4.1 Oversight of public sector schemes by the Pensions Regulator (tPR) began in April 2015, following implementation of the Public Service Pensions Act 2013. TPR made it clear that it would use a "light touch" initially, when exercising this oversight role, and would only start to use its enforcement powers later.

4.2 TPR has taken its first **action to fine** a LGPS administering authority for failure to provide the administering authority's scheme return to tPR. It is a legal responsibility to submit a scheme return by the deadline set by tPR, and after failing to comply despite reminders, tPR issued a penalty notice to the London Borough of Barnet in April 2017. The regulatory intervention report, dated July 2017, summarising this case is attached as **Appendix 3**.

4.3 TPR has also taken its first **action against employers** participating in the Teachers' Pension Scheme. In this case, employers were reported to tPR for failure to submit end of year returns. No fines were issued because the employers complied with regulatory requirements after tPR engagement. The regulatory intervention report, dated February 2017, summarising this case is attached as **Appendix 4**.

4.4 The Teacher's Pension Scheme intervention by tPR helps clarify an area which was previously in doubt, namely how tPR would exercise its powers over employers within a multi-employer scheme, such as the LGPS. Whilst it is now clear that tPR can and will intervene, it is less clear which party would be fined in the event that a fine is levied. Paragraphs 4.11 to 4.17 of this report provide further information on this point.

4.5 In July 2017, tPR published a report detailing its **first criminal prosecutions** of parties failing to provide information requested as part of ongoing investigations into private sector schemes. This acts as a reminder that tPR has criminal prosecution powers under the Pensions Act 2004, and potential fines for this offence are unlimited. The two cases being brought are against <u>advisers</u> to the private sector schemes, namely a solicitor and the head of a charity.

4. Recent actions taken by the Pensions Regulator

BACKGROUND

The Regulator's approach

4.6 Oversight of all public sector schemes by the Pensions Regulator (tPR) began on 1 April 2015, following implementation of the Public Service Pensions Act 2013. TPR issued Code of Practice 14 for public sector schemes and began a programme of educating and engaging with the public sector. TPR made it clear that it would use a "light touch" initially, when exercising its oversight role, and would only start to use its enforcement powers later.

4.7 TPR has now taken its first **action to fine** a LGPS administering authority for failure to provide the administering authority's scheme return. The regulatory intervention report, dated July 2017, summarising this case is attached as **Appendix 3**.

4.8 TPR has also taken its first **action against employers** participating in the Teachers' Pension Scheme. The regulatory intervention report, dated February 2017, summarising this case is attached as **Appendix 4**.

4.9 TPR has made public its **first criminal prosecutions**, which acts as a reminder that tPR has such powers under the Pensions Act 2004. The two cases being brought are against advisers to the private sector schemes, namely a solicitor and the head of a charity.

4.10 The three cases referred to above illustrate the changing approach of tPR, and the move from "light touch" to enforcement and use of its powers. TPR's business plan for 2017/2018 sets out a planned 90% increase in the number of scheme investigations and 25% increase in enforcement cases, so it would appear that tPR is planning to "get tough" with pensions schemes.

The Regulator's powers to intervene with employers participating in the LGPS

4.11 When tPR was first involved with the LGPS, it was clear that its focus was very much on the administering authorities. It was less clear as to whether tPR would look beyond this focus to the participating employers, who also have legal obligations under the LGPS Regulations. This tPR focus was particularly relevant given the fact that the career average LGPS (from April 2014) relies so heavily on accurate payroll data which is provided by employers.

4.12 TPR's intervention within the Teachers' Pension Scheme demonstrates its willingness to get involved, though no fine was levied on that occasion, so it is less clear which party would have been fined if it progressed to that stage.

4.13 The legislation (section 14 of the Pensions Act 2004) does allow tPR to issue an improvement notice or fine directly to 'a third party' (i.e. an employer) if the actions, or failure to act, of that third party has prevented 'a person' (i.e. the administering authority) from meeting the provisions of legislation.

4.14 Clare Gorman sought advice from Karen McWilliam of Aon Hewitt to find out more about how tPR would act, should there be fines levied as a result of a failure by an employer.

In an email from Karen to Clare dated 18 August 2017, Karen sets out:

"*tPR would first work with the employer to remedy the situation (as it did in the Teachers' Pensions cases you refer to). If the employer does not improve its performance, tPR can issue a 'third party notice' specifying what the employer must do to improve and in what timescale. If the employer does not comply with that notice, tPR can issue fines to the third party under section 10 of the Pensions Act 1995.*

Therefore, any such fine would be levied directly on the employer and not via the Administering Authority.

That being said, there is a possibility of a circumstance where the Administering Authority are fined in a situation which is ultimately due to the failure of an employer to provide information. For example, in the case of an Administering Authority consistently failing to meet disclosure timescales for paying retirements due to the employer not providing timely leaver notifications."

4.15 Many administering authorities, including NCC, already have a provision within their Administration Strategy Statements to pass on any such fines to the employer. NCC's Administration Strategy Statement includes the following clause:

"In circumstances where the performance of the employer results in fines being levied on the Administering Authority by the Pensions Regulator, Pensions Ombudsman or other regulatory body, an amount up to the amount of that fine will be recharged to that employer. In addition, there will be an additional charge equal to any associated legal, actuarial and administrative costs the Council has incurred as a result of the employer's action or failure."

4.16 This information provides comfort that tPR will intervene, though administering authorities may be left with a problem in proving the culpability of an employer in order to pass a fine on.

4.17 The Tyne and Wear Pension Fund's Administration Strategy Statement includes a similar provision to enable the administering authority to pass fines on:

"The timescales are based on statutory requirements. Failure to meet them can result in the Pensions Ombudsman and/or Pensions Regulator issuing fines and imposing other maladministration penalties including naming and shaming. Delays can also result in HMRC imposing penalties, including Scheme Sanction Charges. Where a Scheme Sanction Charge has been imposed because of an employer's failure that employer will be required to reimburse the Fund."

Breaking news 22 August 2017

4.18 A story which appeared in the press on 22 August indicates that tPR is now prosecuting former BHS owner Dominic Chappell for his failure to comply with three notices issued under Section 72 of the Pensions Act 2004. The notices requesting information on BHS were issued by the regulator on 26 April 2016, 13 May 2016 and 20 February 2017.

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5. Proposed changes to State Pension Age

Purpose of the report

This report provides information to the Panel about the Government's plans to accelerate the previously proposed increase in State Pension Age and the likely impact on future employer contribution rates payable.

Recommendation

The Panel is requested to accept the report.

Key issues

5.1 On 19 July 2017, the Government announced plans to increase the State Pension Age (SPA) to 68, to be phased in between 2037 and 2039, seven years earlier than originally planned. This will impact those currently aged between 39 and 47, and follows the recommendations of the Cridland report, an independent review.

5.2 Members should note that at this stage this is just a proposal, and changes to SPA require primary legislation which will be subject to full parliamentary scrutiny.

5.3 Any change to SPA is relevant to the LGPS because the LGPS normal retirement age is linked to SPA.

5.4 This Government announcement came at a time when there was much speculation and publicity about reasons for the recently reported slowdowns in the speed of improvements in life expectancy.

5.5 Hymans Robertson, actuary to nearly half of the LGPS, has provided detail of the proposal and likely impact, which is shown in **Appendix 5** to this report. Hymans has estimated that the proposal will affect about 20% of the LGPS active membership and a much smaller proportion of the deferred membership.

5.6 In an email sent on 19 July by Becky Durran of Aon Hewitt to all LGPS clients, Becky states that the impact on future contributions payable by employers if this proposal is brought into legislation is likely to be between 0.1% and 0.2% of pensionable pay. She also points out that the impact will vary from employer to employer reflecting the individual LGPS membership demographics. Becky's email is attached as **Appendix 6** to this report.

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6. Implications of the Brewster decision for the LGPS

Purpose of the report

This report provides information to the Panel about the implications for the LGPS of the Supreme Court's ruling earlier this year in the Brewster case.

Recommendation

The Panel is requested to accept the report.

Key issues

6.1 Details of the recent Brewster judgement are shown in an article which appeared in Public Finance in February 2017, attached as **Appendix 7** to this report. The Brewster judgement determined that the **requirement to nominate** a cohabiting partner was **discriminatory**.

6.2 The Brewster case went to the Supreme Court, and the unanimous judgement, on 8 February 2017, was that the regulatory requirement for a nomination must be disapplied, and that the appellant was entitled to receive a survivor's pension under the scheme. It should be noted that the Brewster case was against the LGPS in Northern Ireland, which is a separate scheme with separate regulations albeit with much in common with the LGPS in England and Wales.

6.3 As the Brewster case was ongoing, the LGPS in England and Wales changed its regulations to remove the nomination requirement for cohabiting partners, so at the time of the Supreme Court ruling, the LGPS in England and Wales was (apparently) not affected by it, having pre-empted the final outcome. However, the case did raise questions about survivor pension payments which had been refused on the grounds that a nomination had not been made before the change in regulations.

6.4 In August 2017, DCLG took the unusual step of writing to administering authorities to provide a view on retrospective claims brought against LGPS administering authorities. The letter from DCLG is attached as **Appendix 8** to this report. Although the letter stresses that it is not legal guidance and does not replace legal advice, it gives a steer that retrospective claims for survivor pensions for cohabitees can now be considered.

6.6 A further case relating to survivor benefits has recently gone to the Supreme Court. John Walker's case is that pension rules restricting same-sex partners are discriminatory. Although this case is not about the LGPS, if successful this is likely to have implications for all pension schemes that restrict same-sex partner benefits and could lead to the LGPS having to offer larger benefits to same-sex partners and possibly even having to recalculate historic cases. Further information will be brought to the Panel on this case.

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7. Outcomes of the July 2017 meeting of the NCC LGPS Local Pension Board

Purpose of the report

This report provides information to the Panel about outcomes and proposals of the meeting of NCC's LGPS Local Pension Board held on 17 July 2017.

Recommendation

The Panel is requested to:

(i) accept the proposals from the Local Pension Board meeting held on 17 July 2017, as set out on Appendix 9 to this report; and

(ii) note the assurances gained by the Board at that meeting.

Key issues

7.1 The NCC LGPS Local Pension Board meets at least twice a year. As noted in the remit of the Pension Fund Panel (within NCC's Constitution) the Panel's functions include ensuring the proper administration of the Local Government Pension Scheme and the "*Board provides oversight of the governance and administration of the LGPS."*

7.2 Since its first meeting in July 2015, the Board has made a number of recommendations to the Scheme Manager for change to the LGPS administration arrangements. Until now, there has been no formal mechanism for communicating Board proposals to the Panel other than by enclosing the minutes of recent Board meeting(s) within the papers served for the Panel meetings.

7.3 From this Panel meeting on, any relevant Board meeting outcomes will be brought to the Panel as a separate agenda item, so the Panel can give those outcomes due consideration.

7.4 A report of the Chair of NCC's LGPS Local Pension Board, covering the outcomes of the Board meeting held on 17 July 2017, is attached as **Appendix 9** to this report. The Chair of the Board will provide further information about those outcomes at this meeting of the Panel.

7.5 Members should note that the Board recommendation to change the format of the Key Performance Indicators (KPIs) for LGPS administration has been adopted for quarter ended 30 June 2017, as shown in report 9, below.

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8. Reporting breaches: progress and quarterly monitoring report

Purpose of the report

This report provides information about breaches of the law which have occurred in the quarter to 30 June 2017.

Recommendation

The Panel is requested to accept the report.

Key issues

8.1 Oversight of the LGPS by the Pensions Regulator (tPR) with effect from 1 April 2015 brought with it the requirement for administering authorities to enforce the LGPS Regulations and supporting law and guidance more assiduously than before due to the requirement to record and (potentially) report breaches of LGPS Regulations. Since April 2015, NCC has reported some breaches of the law to the Panel, quarterly, and considered whether each recorded breach is *of material significance to the Regulator* and should be reported to tPR.

8.2 Since 1 April 2015, all breaches in relation to contributions receivable, pensionable pay information and ABSs have been reported to the Panel. Since 1 April 2016, all other known breaches have also been reported to the Panel.

8.3 In the quarter to 30 June 2017 there was one breach of the requirement to pay contributions within 19 days of the month end, which is shown in **Appendix 10** to this report. The amount due to the Fund was paid later in the month.

8.4 The following records of breaches for the Pensions Administration Team are **enclosed** with these papers for the:

- quarter ended 30 June 2017 (an A3 spreadsheet);
- quarter ended 31 March 2017 (a separate A3 spreadsheet), showing brought forward breaches that had not been resolved when reported to the July 2017 Panel meeting;
- quarter ended 31 December 2016 (a separate A3 spreadsheet), showing brought forward breaches that had not been resolved when reported to the February 2017 and July 2017 Panel meetings; and
- quarter ended 30 September 2016 (a separate A3 spreadsheet), showing brought forward breaches that had not been resolved when reported to the November 2016, February 2017 and July 2017 Panel meetings.

8.5 A report commissioned from Aon Hewitt to review NCC's breaches reporting practices in the periods to 31 March 2017 is included in report 4 of the confidential Report of the Director of Corporate Resources to this meeting.

8. Reporting breaches: progress and quarterly monitoring report

BACKGROUND

8.6 Oversight of the LGPS by the Pensions Regulator (tPR) with effect from 1 April 2015 brought with it the requirement for administering authorities to enforce the LGPS Regulations and supporting law and guidance more assiduously than before due to the new requirement to record and (potentially) report all breaches of LGPS Regulations.

8.7 Since April 2015, NCC has reported some breaches of the law to the Panel on a quarterly basis and considered whether each breach is *of material significance to the Regulator* and should be reported to the Regulator. The breaches reported to the Panel form the Northumberland County Council Pension Fund's breaches log. These breaches are recorded so the Panel can assess whether, in its view, any item is of material significance to tPR and should be reported to tPR.

8.8 A NCC Pension Fund Breaches Procedure was approved at the September 2015 meeting of the Pension Fund Panel, applicable with effect from 1 April 2015. Breaches occurring in the quarter to 30 June 2015 (only in relation to contributions and pensionable pay information) were reported to the September 2015 Panel.

<u>Breaches in relation to contributions and provision of Annual Benefit Statements</u>

8.9 From 1 April 2015 all known breaches in relation to contributions receivable, pensionable pay information and Annual Benefit Statements (ABSs) have been recorded in the breaches log and reported to the Panel. To date, none of the recorded breaches have been viewed as being of material significance to tPR, so none have been reported to the Regulator.

8.10 The Panel *and* Board has given careful consideration to reporting the breaches in issuing the 2014/2015 ABSs and 2015/2016 ABSs by their respective 31 August deadlines, and after taking all relevant information into account.

8.11 At the Board meeting held on 3 November 2016, the Board considered the 2015/2016 ABS breaches in detail concluding that they were not reportable to tPR on this occasion, and made detailed recommendations and comments to the Scheme Manager which were reported to the November 2016 Panel meeting.

<u>Breaches in relation to pensions administration</u>

8.12 As a result of staffing issues in NCC's Pensions Administration Team, recording breaches in the log did not begin until the quarter ended 30 June 2016.

8.13 In August 2016, after taking advice from Karen McWilliam of Aon Hewitt, Clare Gorman consulted with the (then) Chairman and Vice Chairman of the Panel to obtain authority to:

- start the process of full breaches recording from the quarter ended 30 June 2016, rather than backdating; and
- include in the breaches log any breaches the Pensions Administration Team is aware of from earlier periods if they have not already been fully resolved.

8.14 The Chairman and Vice Chairman were supportive of this approach, noting that the most important part of the breaches procedure is recognising as quickly as possible that there has been a breach; ensuring that it has been corrected on a timely basis with no detriment to any LGPS member; and that any system failures are quickly addressed.

8.15 The following records of breaches for the Pensions Administration Team are **enclosed** with these papers for the:

- quarter ended 30 June 2017 (an A3 spreadsheet);
- quarter ended 31 March 2017 (a separate A3 spreadsheet), showing brought forward breaches that had not been resolved when reported to the July 2017 Panel meeting;
- quarter ended 31 December 2016 (a separate A3 spreadsheet), showing brought forward breaches that had not been resolved when reported to the February 2017 and July 2017 Panel meetings; and
- quarter ended 30 September 2016 (a separate A3 spreadsheet), showing brought forward breaches that had not been resolved when reported to the November 2016, February 2017 and July 2017 Panel meetings.

8.16 In the quarter to 30 June 2017 there was one breach of the requirement to pay contributions within 19 days of the month end, which is shown in **Appendix 10** to this report.

<u>Review of NCC's practices to record breaches</u>

8.17 A report commissioned from Aon Hewitt to review NCC's breaches reporting practices in the periods to 31 March 2017 is included in report 4 of the confidential Report of the Director of Corporate Resources to this meeting.

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9. Key Performance Indicators (KPIs) for LGPS administration

Purpose of the report

The purpose of this report is to provide information to the Panel about the KPIs in the quarter to 30 June 2017.

Recommendation

The Panel is requested to accept the report.

Key issues

9.1 The NCC Pension Fund's Administration Strategy Statement was updated and approved at the November 2016 Panel meeting. The Statement refers to Key Performance Indicators (KPIs) for the NCC Pensions Administration Team. These KPIs have been reported to the Panel on a quarterly basis since the quarter to 31 December 2016.

9.2 **Appendix 11** sets out the KPIs in full, and the achievements for the quarter ended 30 June 2017 compared with the previous two quarters. Following the recommendation of NCC's LGPS Local Pension Board,

9.3 Compared to the previous quarters, the KPI to inform leavers of rights or options has worsened. This is because of other work commitments, such as paying benefits for deaths and retirements taking priority over calculation of deferred benefits in the quarter. Also, workloads are high in the 30 June quarter due to end of year processing, and the start of the work to produce Annual Benefit Statements. The end of year processing reveals information about leavers that the Pensions Administration Team was previously unaware of, which can indicate a breach. Other KPIs have shown an improvement.

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10. FCA's report on the UK asset management industry

Purpose of the report

This report provides information about the Financial Conduct Authority's (FCA) final report, published in June 2017, on the UK asset management industry.

Recommendation

The Panel is requested to accept the report.

Key issues

10.1 The FCA published an interim report in November 2016 stating that it would make a market investigation reference (MIR) to the Competition and Markets Authority (CMA) covering concerns over conflicts of interests among investment advisers, and the potential for consultants to encourage existing advisory clients into more lucrative "fiduciary management" mandates.

10.2 The FCA website states:
"As part of our Asset Management Market Study we made a provisional decision to make a market investigation reference (MIR) of investment consultancy services. On 20 February 2017, Aon Hewitt, Mercer and Willis Towers Watson offered undertakings in lieu (UIL) for us to consider instead of making a MIR. UIL are essentially undertakings from a firm that they will amend their practices without us making new rules. On 28 June 2017 we wrote to the 3 firms to explain why, after careful review, we have reached the provisional view of a proposal to reject the UIL."

10.3 Following the announcement in June 2017 that the FCA was likely to reject the UIL received from the three large constancy firms, the FCA consulted with the industry again, inviting comments by 26 July 2017. The FCA will publish a decision on whether it will make a MIR in September 2017.

10.4 **Appendix 12**, attached to this report, provides background information on the FCA interim and final reports and industry reaction, and **Appendix 13** contains Mercer's communication to clients, following the publication in June 2017 of the final report, to explain its position. Hymans Robertson has a different approach to Mercer because it does not offer fiduciary management services, and its response to the consultation is attached as **Appendix 14**.

10.5 Mercer currently provides investment advisory services to the Panel and NCC, as administering authority for the LGPS. The FCA's proposed action has no immediate impact on NCC Pension Fund or the relationship with Mercer, though the outcome of the FCA consultation may herald wider changes within the investment advisory industry, which could, in time, affect Mercer's relationships with clients.

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11. Scheme Advisory Board's consultation on academies in the LGPS

Purpose of the report

This report provides details of the LGPS Scheme Advisory Board (SAB) consultation, "*LGPS - Academies Objective,*" and the proposed response from NCC Pension Fund.

Recommendation

The Panel is requested to endorse the proposed response to consultation, set out in paragraph 11.4, below.

Key issues

11.1 Members received a report at the July 2017 meeting of the Panel, which described the May 2017 PwC report, commissioned by the SAB, which analysed the options for treatment of academies in the LGPS. The PwC report did not make any recommendations.

11.2 On 17 July 2017, SAB launched a consultation entitled "*LGPS - Academies Objective,*" seeking views from administering authorities, pensions committees, and other interested parties. SAB is investigating the issues and developing options to address those issues with regard to Government policy to promote conversions of schools to academy status. This consultation, attached as **Appendix 15** to this report, seeks views on the proposed objectives of this work.

11.3 The proposed draft objectives being suggested by SAB are:

- "*Protect the benefits of scheme members through continued access to the LGPS*
- *Ring fence local tax payers and other scheme employers from the liabilities of the academy trust sector*
- *Improve the efficiency and effectiveness of administrative practices*
- *Increase the accuracy and reliability of data*

In achieving the above any options for changes should not:

- *Significantly alter cash flows at the fund level*
- *Significantly alter assets at the pool level."*

11.4 It is proposed that the response to the consultation on behalf of NCC Pension Fund is to **agree the objectives** set out in paragraph 11.3 above. For the Fund, the most important objective is to ensure that participating employers are protected from any liabilities that may result from an academy default, and this objective is covered by the second bullet point in 11.3 above. The third and fourth bullet points in 11.3 above aim to address the problems encountered by funds as a result of a proliferation of the number of academies participating in the LGPS without the knowledge and expertise to adequately fulfil the legal obligations that accompany being a LGPS Scheme employer.

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12. Implementation of the Markets in Financial Instruments Directive (MiFID II)

Purpose of the report

This report outlines the impact of the implementation of MiFID II and the risk to NCC Pension Fund's investment strategy of the Fund being reclassified as retail client on 3 January 2018, and recommends that the Panel agree, where necessary, that elections for professional client status should be made, as soon as practical.

Recommendation

The Panel is requested to

(i) note the potential impact on the Fund's investment strategy of becoming a retail client from 3 January 2018 and endorse the commencement of applications for elected professional client status with all relevant institutions;

(ii) where necessary, agree to forgo the protections available to retail clients, set out in Appendix 17 to this report; and

(iii) delegate to the Director of Corporate Services to complete the opt up applications and determine the basis of the application, as either full or specified service.

Key issues

12.1 Currently, administering authorities are automatically categorised as "per se professional" clients in respect of MiFID and non-MiFID scope business, which enables them to invest in a full range of asset classes. After 3 January 2018, administering authorities will be downgraded to "retail" client status, unless they complete an opt up process, to achieve "elective professional" status.

12.2 To opt up to elective professional status, administering authorities must prove that they meet the FCA's opt up criteria, as set out in **Appendix 16**. The standard template, recommended for administering authorities by the LGPS Scheme Advisory Board for opting up to professional client status, is attached as **Appendix 18**.

12.3 In opting up, administering authorities must forgo the protections that come with retail client status, as set out in **Appendix 17** to this report.

12.4 It is likely that NCC Pension Fund will need to complete the opt up process with all or most of its existing fund managers, as well as with the investment adviser (Mercer) and the Fund's custodian (Northern Trust). Members should also note that in many cases, fund managers will no longer be able to even discuss certain asset classes and vehicles with the authority if the authority is classed as a retail client by that manager. In other words, before even receiving information on certain new investments, the authority would need to opt up.

12. Implementation of the Markets in Financial Instruments Directive (MiFID II)

BACKGROUND

Report to the Panel in January 2017

12.5 The Panel received a report at the meeting held on 27 January 2017 on the Financial Conduct Authority's (FCA) consultation on MiFID II and its likely impact on NCC Pension Fund.

12.6 In September 2016, the Financial Conduct Authority (FCA) consulted on proposals to implement the Markets in Financial Instruments Directive (MiFID) II, with responses invited by 4 January 2017. The FCA must implement MiFID II in the UK and the September 2016 consultation was on *how* it would be implemented, not whether it would be implemented.

12.7 The FCA proposals were to **reclassify the status** of local authorities when carrying out investment transactions. Under the proposals, all local authorities including pension funds, would be classed as "**retail**" clients from **3 January 2018**, rather than "**per se professional**" clients, as before.

12.8 Retail clients are severely limited in their investment options, so retail categorisation would have a major impact on local authorities' ability to invest in many asset classes and to fulfil the regulatory requirement to consider a wide variety of investments.

12.9 At that time, it was clear that LGPS administering authorities could **opt up** to professional client status, which is similar to per se professional client status. However, there was significant doubt as to whether many (including NCC Pension Fund) would meet the FCA's suggested criteria for opting up.

12.10 Also, it is for each investment manager to *choose* to assess whether the authority meets the opt up criteria, and there may be business reasons for a manager choosing not to assess.

12.11 The FCA proposals in September 2016 would have caused many serious difficulties for local authorities, including the possibility of being required to sell investments they could no longer hold due to the change of status.

12.12 At that time, the Local Government Association (LGA), LGPS Scheme Advisory Board (SAB), the Department for Communities and Local Government (DCLG) and the Investment Association (IA) lobbied the FCA to make the test better fitted to the unique situation of local authorities.

Introduction of the third quantitative test

12.13 In early April 2017, there were indications from the FCA that a third quantitative test would be introduced to the opt up criteria, and this test was simply that the client seeking to opt up would need to be a LGPS administering authority. The introduction of this test was a major step forward, as it meant that all LGPS funds *should* now be in a position to meet the opt up criteria. However, it was not until 3 July 2017 that the FCA issued its final policy statement which confirmed the addition of this third test.

FCA's final policy statement on MiFID II

12.14 In July 2017, the FCA published a policy statement setting out the final rules for implementation of MiFID II and the opt up criteria. Hymans Robertson's sixty second summary on **MiFID II, July 2017 update** is attached as **Appendix 16** to this report. This provides a succinct explanation of the opt up tests that must be met to achieve professional client status.

12.15 The final policy statement reiterates that following the introduction of MiFID II from 3 January 2018, financial services firms will no longer be able to categorise an administering authority as a "per se professional" client for both MiFID *and* non-MiFID scope business. Instead, all local authorities must be classified as retail clients unless they are opted up by firms to an elective professional client status.

12.16 The FCA has exercised its discretion to adopt the opt up criteria for the purposes of the quantitative tests, which local authority clients must satisfy in order for firms to reclassify them as elective professional clients.

<u>Potential impact of being downgraded to retail client status</u>

12.17 A move to retail client status would mean that all financial services firms, such as banks, brokers, advisers and fund managers, would have to treat a local authority in the same way they treat non-professional individuals and small businesses. That treatment includes a raft of protections ensuring that:

- investment products are suitable for the customer's needs: and
- all the risks and features of a product have been fully explained.

This provides a higher standard of protection for the client but it also involves more work and potential cost for both the firm and the client to prove that all such requirements have been met.

12.18 The retail client protections that are lost on opt up to professional client status are set out in **Appendix 17** to this report.

12.19. Having such protections would come at the price of local authorities being unable to access the wide range of assets needed to implement an effective, diversified investment strategy. Retail client status would significantly restrict the range of financial institutions and instruments available to authorities.

12.20 Many institutions currently servicing the LGPS (including Legal and General and Northern Trust) are not authorised to deal with retail clients, and may not wish to undergo the required changes to resources and permissions in order to do so.

12.21 Even if the institution secures the ability to deal with retail clients, the range of instruments it can make available to the client would be limited to those defined under FCA rules as "non-complex" which would exclude many of the asset classes currently included in LGPS fund portfolios. In many cases, managers will no longer be able to even discuss (i.e. "promote") certain asset classes and vehicles with the authority, if the authority is classed as a retail client.

Election for professional client status

12.22 MiFID II does allow for retail clients that meet certain conditions to elect to be treated as professional clients (i.e. to "opt up"). There are two tests which must be met by the client when being assessed by the financial institution, i.e. the quantitative and the qualitative test.

12.23 The tests recognise the status of LGPS administering authorities as providing a "pass" for the quantitative test. Following changes made to the opt up criteria in July 2017, the qualitative test can now be performed on the administering authority **as a collective** rather than an as an individual.

12.24 The SAB, the LGA, the IA and other industry bodies have developed a **template** opt up process to help LGPS funds and their financial service providers to complete the opt up process prior to the 3 January 2018 deadline. This template process should enable a consistent approach to assessment, and should prevent authorities from having to submit a variety of information in different formats.

12.25 The election to professional status must be completed with all financial institutions prior to the change of status on 3 January 2018. Failure to do so by local authorities would result in the financial institution having to take "appropriate action" which could include terminating the relationship, at a significant financial risk to the authority.

12.26 Applications can be made in respect of either all of the services offered by the institution (even if not already being accessed) or a particular service only.

12.27 Authorities are not required to renew elections on a regular basis but will be required to review the information provided in the opt up process and notify all financial services firms of **any changes** in circumstances which could affect their status, for example, if the membership of the pensions committee changed resulting in significant loss of experience, or if the relationship with the authority's investment adviser was terminated.

LGPS pools

12.28 LGPS pools will be professional investors in their own right so they will not need to opt up with the external financial institutions they use. Authorities will need to opt up with their LGPS pool in order to access the full range of services and sub-funds on offer.

12.29 In some circumstances, in particular where the pool only offers access to fund structures such as an ACS, the pool could use "safe harbour" provisions resulting from local authorities continuing to be named as professional investors in both the Financial Promotion Order or in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order. These provisions would enable the promotion and potentially the sale of units in fund structures to local authorities as retail investors.

12.30 Elections to professional status will be needed for every financial institution that the authority uses outside of the pool, both existing and new, together with a continuing review of all elections. If all new transactions are made via fund structures within the pool then no new elections will be required. Authorities would only need an ongoing review of the elections made with the pool and with any legacy external institutions, the number of which would reduce as assets are transferred to the pool.

Next steps: per LGA/SAB advice

12.31 The LGA/SAB advice to LGPS administering authorities is that in order to continue to effectively implement the authority's investment strategy after 3 January 2018, applications for election to be treated as a professional client should be submitted to all financial institutions with whom the authority has an existing or potential relationship, in relation to the investment of the pension fund.

12.32 This process should commence as soon as possible in order to ensure it is completed in good time and to avoid the need for "appropriate action" to be taken by institutions in relation to the authority's pension fund investments.

12.33 The officer named in the recommendations should be granted the necessary delegation to make applications on the authority's behalf and to determine the nature of the application on either full range of services or a particular service(s) only. Therefore, this report seeks authority from the Panel to delegate to the Director of Corporate Resources to make applications to the administering authority's relevant current and potential financial service providers to enable NCC Pension Fund to continue to access the full range of investments needed to fulfil its LGPS regulatory obligations.

12.34 The standard template for opting up to professional client status is attached as **Appendix 18** to this report. This template states:

"*The "qualitative test" requires a firm to undertake an assessment of the expertise, experience and knowledge of the local authority, in order for the firm to be reasonably assured, in light of the nature of the transactions or services envisaged, that the local authority is capable of making its own investment decisions and understanding the risks involved."*

Therefore, this report seeks authority from the Panel to acknowledge and agree to forgo the protections available to retail clients, as set out in Appendix 17.

Implications for NCC Pension Fund

12.35 At the end of July 2017, officers contacted all of the fund managers with whom NCC Pension Fund has a current relationship, as well the Fund's custodian (Northern Trust) and investment adviser (Mercer) to seek their views on the requirement for NCC (as administering authority) to opt up to professional client status, and if required, whether that should be for the potential full range of services offered, or for a restricted range.

12.36 Most of those contacted have now responded, though some sent a holding reply. **Appendix 19** to this report shows the status on all responses received prior to 23 August 2017. It is possible that the list of current relationships shown is not complete, for example, NCC Pensions Fund has a bank account (with Barclays) for the day to day cash management, which may also be in scope.

12.37 As can be seen from the responses shown in Appendix 19, there remains a good deal of doubt, within the fund management industry, about what is in scope, whether opting up needs to be retrospective (i.e. for existing relationships for closed funds).

12.38 So far, only Legal and General and Northern Trust have indicated that both view it as imperative, for the ongoing relationship with NCC Pension Fund, that the Fund successfully opts up to professional client status.

12.39 It is likely that NCC, as administering authority, will need to opt up to professional client status for some, if not all of its existing financial service relationships. To do so, certain permissions will be needed, and these are covered by the resolutions requested in this report.

12.40 As timescales for opt up are very tight, despite the remaining uncertainty over which service providers will come into scope, the necessary permissions have been requested at this meeting to enable officers to proceed with the opt up process as soon as there is clarity on which providers are in scope.

Advice obtained from Mercer

12.41 In an email from Joanne Holden to Clare Gorman on 23 August, responding to the question:

"Would you recommend opting up for each of NCC Pension Fund's managers, and if so, should that be for the current product invested in only, or for the fund manager's total product offering?"

Joanne says:
"In short, and you would need to confirm this with the managers, but if you didn't opt up, there would be a very strong chance that you would need to disinvest from your current holdings and invest in retail appropriate funds. The danger is that such funds do not exist at your current providers (more likely with assets such as private equity), and if they do (which may be the case say with passive equities and bonds), the fees payable may be higher.

However, if you are at all uncomfortable with the protections you will lose in opting up from retail to professional, you should not apply to opt up.

Looking ahead to pooling, it is my understanding that BCPP will be authorised to provide offerings for professional clients only, which again suggests that alternative options would need to be sought if the Fund did not want to opt up."

12.42 In light of this advice and advice from LGA and SAB, officers will proceed with the opt up process, as soon as possible, for the NCC Pension Fund relationships where it is deemed necessary.

MEETING OF THE PENSION FUND PANEL

4 SEPTEMBER 2017

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

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13. Training needs analysis

Purpose of the report

The purpose of this report is to introduce a formal training needs analysis procedure for NCC Pension Fund, to be completed annually by Panel and Board members

Recommendation

> **The Panel is requested to note the introduction of a formal training needs analysis procedure, and each member of the Panel and Board is asked to complete the form, attached as Appendix 21 to this report.**

Key issues

13.1 NCC Pension Fund adopted a formal Training Policy in 2015 which was last updated in February 2016 and is attached as **Appendix 20** to this report. This Policy applies to Panel and Local Pension Board members, as well as senior officers involved in the management of the Fund and administration of the LGPS.

13.2 The Policy aims to comply with CIPFA's Knowledge and Skills Framework, and states that a training needs analysis procedure will be developed.

13.3 Within the LGPS Scheme Advisory Board's (SAB) standard template for opting up to elective professional status (which is attached as **Appendix 18**), there are two questions that ask whether those directly involved in decision making are required to complete a self-assessment with regard to their understanding, one regarding risk management, and the other regarding knowledge of investments.

13.4 Therefore, in order for NCC Pension Fund to respond positively to the template questions about self-assessment, a training needs analysis procedure has been developed. The training needs analysis form for completion is attached as **Appendix 21**. The SAB standard template information is only asking for training needs analysis information on members of the decision making body (i.e. the Pension Fund Panel), but to meet best practice guidelines and NCC Pension Fund's adopted Training Policy, the training needs analysis applies to Panel and Board members, as well as to senior officers.

13.5 Each Panel and Board member is asked to complete the training needs analysis form and return it to Craig Johnson by 22 September 2017. The results will be analysed and taken into account when developing the Fund's Training Plan, to be delivered in the next twelve months.

13.6 Members will be asked to complete the training needs analysis forms annually, from now on.

MEETING OF THE PENSION FUND PANEL

4 SEPTEMBER 2017

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

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14. Fund performance and total Fund value

Purpose of the report

The purpose of this report is to provide information to the Panel about the Fund performance in the quarter to 30 June 2017 and the total Fund value at that date.

Recommendation

The Panel is requested to accept the report.

Key issues

14.1 The total Fund value (externally managed) was **£1,309** million as at 30 June 2017, compared to £1,314 million as at 31 March 2017, reflecting the low positive investment returns over the quarter, offset by some cash outflow in the quarter.

14.2 The Fund returned **0.3%** in the quarter to 30 June 2017, underperforming its benchmark return of 0.4%. The returns for the year to 30 June 2017 were 17.6%, outperforming the benchmark of 16.4% by 1.1%.

14.3 This has been a flat quarter for NCC Pension Fund's performance, with positive contributions from UK equities, property and some overseas equities, offset by negative contributions from private equity, infrastructure and index linked gilts. In the year to 30 June 2017, the only negative contribution to performance was from Wellington's Global Total Return fund, which returned -1.2% over twelve months, against its benchmark of -0.4%.

14.4 Further detail of annual and quarterly performance by manager and asset class for the period ending 30 June 2017 is shown in the **enclosed** "*Quarterly Risk and Return Analysis*" provided by Portfolio Evaluation Ltd (the Fund's performance measurement service provider).

14. Fund performance and total Fund value

BACKGROUND

Total Fund value

14.5 The total value of the Fund at the last four quarter ends is as follows:

	as at 30 September 2016 £m	as at 31 December 2016 £m	as at 31 March 2017 £m	as at 30 June 2017 £m
Legal and General *Index tracker*	**908.77**	**1008.96**	**1051.55**	**1054.40**
M&G Investments *Active global equities*	**71.38**	**0.0**	**0.0**	**0.0**
Wellington *Active corporate bonds*	**97.76**	**98.30**	**99.91**	**101.25**
Schroder	25.16	25.94	25.11	26.76
BlackRock	24.57	24.27	26.35	25.49
Property **subtotal**	**49.73**	**50.21**	**51.46**	**52.25**
Morgan Stanley	34.60	35.67	34.71	28.60
NB Crossroads	19.53	21.09	26.17	21.47
Private equity **subtotal**	**54.13**	**56.76**	**60.88**	**50.07**
GIP	26.89	31.07	32.11	31.52
Antin	15.43	18.34	17.93	18.93
Infrastructure **subtotal**	**42.32**	**49.41**	**50.04**	**50.45**
Total	**1,224.09**	**1,263.64**	**1,313.84**	**1,308.42**

Note that capital calls and capital repayments have been made during the year to 30 June 2017 for private equity and infrastructure investments. Extra funding, when needed, came out of cash held by the Pension Fund for the day-to-day expenditure incurred in administering the Scheme and by disinvesting from Legal and General. Capital repayments have been transferred to Legal and General to invest, or when timing can be matched, used to pay other capital calls.

14.6 Further detail of annual and quarterly performance by manager and asset class for the period ending 30 June 2017 is shown in the **enclosed** "*Quarterly Risk and Return Analysis*" provided by Portfolio Evaluation Ltd (the Fund's performance measurement service provider).

Fund performance

14.7 The Fund's performance is measured by Portfolio Evaluation Ltd (formerly, until 31 March 2016 by the WM Company, later known as State Street/GS Performance Services). Shown below are the annual returns achieved by the Fund for the five years to 31 March 2017 and for the latest four quarters. Also shown are the annualised returns achieved by the Fund for the five years to 31 March 2017.

14.8 **Annual returns**

	Financial Year Ended 31 March				
	2013	2014	2015	2016	2017
	%	%	%	%	%
Fund	14.0	3.8	13.2	-0.7	24.2
Benchmark	14.2	3.7	13.1	-1.2	24.1

14.9 **Quarterly returns**

	- - - 2016/17 - - -			
	Quarter 3 2016 to 30 Sep 16 %	Quarter 4 2016 to 31 Dec 16 %	Quarter 1 2017 to 31 Mar 17 %	Quarter 2 2017 to 30 Jun 17 %
Fund	8.5	3.6	4.0	0.3
Benchmark	8.1	2.9	4.3	0.4

14.10 **Annualised returns**

	All Financial Years Ended 31 March		
	2012/17	2014/17	2017
	%	%	%
Fund	10.6	11.8	24.2
Benchmark	10.4	11.6	24.1
	5 years	3 years	1 year

IMPLICATIONS ARISING OUT OF THE REPORT

This applies to items 1. to 14. (inclusive) in this report

Policy:	None
Finance and value for money:	All investment decisions and funding strategy decisions could have an implication for the future employer contribution rates payable by employers participating in the Pension Fund. There are no investment decisions arising directly from these reports.
Human Resources:	None
Property:	None
Equalities:	None
Risk Assessment:	A risk assessment is performed as part of the asset liability modelling study undertaken periodically (usually every three years) to set the Fund's asset allocation strategy. There is no change to investment strategy contained within these reports.
Sustainability:	None
Crime & Disorder:	None
Customer considerations:	None
Consultation:	None
Electoral divisions:	All

Report sign off

Finance Officer	N/A
Monitoring Officer/Legal	N/A
Human Resources	N/A
Procurement	N/A
I.T.	N/A
Director (Corporate Resources)	AE
Portfolio Holder(s)	N/A

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