



Northumberland  
County Council

**MEETING OF THE PENSION FUND PANEL**

**20 SEPTEMBER 2019**

**REPORT OF THE SERVICE DIRECTOR - FINANCE**

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**1. Northumberland County Council Pension Fund: 2018/19 Annual Report and Accounts and external audit**

**Purpose of the report**

This report updates the Panel on the finalisation of the Northumberland County Council Pension Fund (NCCPF) Annual Report and Accounts for the year to 31 March 2019, and provides the external auditor's "***Audit Results Report***".

**Recommendation**

**The Panel is requested to accept the report.**

**Key issues**

- 1.1 The NCCPF annual accounts form part of the NCC annual Financial Statements, reflecting the legal status of the Fund as part of NCC. The LGPS Regulations also require a **separate** Pension Fund Annual Report and Accounts to be prepared and published, so the Fund accounts appear in both documents.
- 1.2 NCC's Audit Committee gives approval, each year, to finalise NCC's Financial Statements and NCCPF's Annual Report and Accounts. NCC's 2018/19 Financial Statements and NCCPF's Annual Report were due to be finalised at Audit Committee on 24 July 2019, but finalisation was deferred due to ongoing external audit investigations. It is likely that the 2018/19 Financial Statements and Annual Report will now be approved at Audit Committee on 25 September 2019.
- 1.3 The **draft** NCCPF Annual Report and Accounts for 2018/19 was reported to the Pension Fund Panel at its meeting held on 21 June 2019. No significant changes have since been made to this draft. As the final version is not yet available due to the audit issues referred to above, the latest draft version has been published on NCC's website, and the final version will replace it once audit approval has been given.
- 1.4 Claire Mellons (Manager) and Hassan Rohimun (Partner) of Ernst & Young LLP (EY), the Council's external auditors, will attend this meeting of the Panel to present EY's "***Audit Results Report***" (also known as an ISA 260) on the 2018/19 NCCPF Accounts. The EY draft report is **enclosed** with these papers.
- 1.5 The enclosed Audit Results Report was also reported to the Audit Committee meeting on 24 July 2019.

## 1. Northumberland County Council Pension Fund: 2018/19 Annual Report and Accounts and external audit

### BACKGROUND

- 1.6 The **draft** NCCPF Annual Report and Accounts for 2018/19 were reported to the Pension Fund Panel at its meeting on 21 June 2019.
- 1.7 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 Annual Financial Statements. The "**true and fair**" audit opinion is provided on NCC's Financial Statements.
- 1.8 There is a regulatory 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.
- 1.9 The LGPS Regulations require publication of the Pension Fund's final 2018/19 Annual Report before 1 December 2019.
- 1.10 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, **not** a separate legal entity.

### External audit of NCCPF's Annual Report and Accounts for 2018/19

- 1.11 EY's **Audit Plan** for 2018/19 for NCCPF was presented to the February 2019 Panel meeting, and the audit results will be presented at this meeting.
- 1.12 Claire Mellons (Manager) and Hassan Rohimun (Partner) of EY will attend this meeting of the Pension Fund Panel to present EY's "**Audit Results Report**" on the 2018/19 NCCPF Annual Report and Accounts. The draft Audit Results Report is **enclosed** with these papers. It has already been presented to the Audit Committee on 24 July 2019.
- 1.13 EY's audit field work on the Fund's 2018/19 Annual Report and Accounts was completed at the end of July 2019.
- 1.14 Unadjusted differences in the value of Pension Fund investments of £4.6 million have been identified and described on **page 16** in the enclosed EY report. These relate to updated valuations of certain private equity and infrastructure investments being provided by investment managers too late to be incorporated in the draft accounts.
- 1.15 In common with most other authorities, NCC has adopted the approach that unless there is a **material** change to the draft accounts, they will not be changed.
- 1.16 Two weaknesses in the control environment are identified (on **page 20**) in the EY report. No problems have been noted as a result of the control weaknesses. The control weaknesses arise from use of NCC financial systems and are also referred to in the audit results report for NCC's financial statements.

## NCC's Audit Committee review of the 2018/19 draft Financial Statements

- 1.17 NCC's 2018/19 **draft** Financial Statements (incorporating the NCCPF accounts) and NCCPF's 2018/19 **draft** Annual Report and Accounts were provided to members of the Audit Committee, who were invited to attend one of two "drop in" sessions held in June, where officers were available to provide information and explanations.
- 1.18 NCCPF's 2018/19 draft Annual Report was reviewed at the NCC Audit Committee meeting held on 24 July 2019. The usual practice is for the Section 151 Officer and the external auditor to sign (and therefore finalise) NCC's Financial Statements and NCCPF's Annual Report at the Audit Committee meeting held each year in late July.
- 1.19 This sign off process was not possible at the 24 July 2019 meeting because at that point, EY was investigating an issue raised by a whistleblower which, in EY's view, could have a material bearing on NCC's 2018/19 Financial Statements. As a result of this audit delay, NCC has failed to meet the legal deadline for finalising its Financial Statements by the end of July in 2019.
- 1.20 As EY could not give a "true and fair" audit opinion on NCC's Financial Statements in July, also it could not provide a "consistent with" opinion on NCCPF's Annual Report, so neither set of accounts have been finalised.

## NCCPF 2018/19 Annual Report finalisation

- 1.21 At the time of finalising this report, there was no certainty as to when EY would be in a position to complete its audit work on NCC's 2018/19 Financial Statements, but there was an expectation that the audit opinion would be signed at Audit Committee on 25 September 2019.
- 1.22 In an email from Claire Mellons of EY to Clare Gorman on 27 August, referring to the additional audit work being undertaken for NCC, Claire said:  
  
*"Until this work is complete, and we have had the chance to consider the impact of our findings on both the Council and Pension Fund we won't be able to issue our final Audit Results Report for the Pension Fund."*
- 1.23 EY will provide a verbal update at this meeting, but in the meantime, the NCCPF 2018/19 Annual Report and the EY Audit Results Report both remain in draft form, pending the completion and reporting of EY's findings from the additional work.
- 1.24 Minor changes have been made to the version of the NCCPF draft 2018/19 Annual Report brought to the 21 June 2019 Panel, and no further changes are expected. As the final version is not yet available, the latest draft version has been published on NCC's website, and the final version will be published to replace it once audit approval has been given.
- 1.25 Once finalised, the NCCPF Annual Report for 2018/2019 will be sent to the employers participating in the Fund and other interested parties.
- 1.26 Unless there are significant changes to the 2018/19 Annual Report and/or the Audit Results Report, they will not be brought back to the Pension Fund Panel.



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## REPORT OF THE SERVICE DIRECTOR - FINANCE

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### 2. Investment Strategy Statement update

#### Purpose of the report

This report seeks Panel approval to update NCCPF's LGPS Investment Strategy Statement (ISS).

#### Recommendation

The Panel is requested to:

- (i) approve the draft NCCPF LGPS Investment Strategy Statement (ISS) attached as Appendix 1 to this report; and
- (ii) delegate authority to the Service Director - Finance in consultation with the Chair and Vice Chair of the Panel to make any further changes required as a result of consultation with the participating employers and trade unions.

#### Key issues

- 2.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require administering authorities to have an Investment Strategy Statement (ISS) in place. The Regulations include a requirement to invest in a "wide variety" of investments and set out the authority's approach to matters such as risk, pooling, environmental, social and corporate governance issues and exercise of voting rights. The ISS must be prepared in accordance with MHCLG's guidance.
- 2.2 The ISS must be reviewed at least every three years, and NCCPF's ISS was last reviewed and approved by the Panel in February 2019. At the Panel meeting held on 12 July 2019 the decision was made to change the target benchmark allocations for NCCPF's publicly quoted equities. Report 5 on the private Report of the Service Director – Finance provides more detail of the new benchmark.
- 2.3 Changes are currently being made, and the new asset allocation will be in place on **1 October 2019**. The current version of the ISS reflects the previous asset allocation for NCCPF, so an updated *draft* ISS, effective from 1 October 2019, has been prepared and attached as **Appendix 1**. The Panel is asked to approve this updated ISS at this meeting.
- 2.4 The Regulations require consultation on the contents of the ISS. Therefore consultation on the revised version will take place following this meeting. A delegation is sought to make changes to the ISS after this meeting, if appropriate, as a result of any comments received from the consultation process.

## 2. Investment Strategy Statement update

### BACKGROUND

#### Requirement to formulate and publish an Investment Strategy Statement (ISS)

2.5 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require each administering authority to formulate and publish a statement of its investment strategy.

2.6 Regulation 7 of the LGPS (Management and Investment of Funds) Regulations 2016 sets out:

#### ***“Investment strategy statement***

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

***(2) The authority’s investment strategy must include—***

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

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

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

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

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

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

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

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

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

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

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

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

#### ISS update from 1 October 2019

- 2.7 Whilst there is a legal requirement to review the ISS at least every three years, in practice, NCCPF's ISS is reviewed each February so that an up to date version can be included in the Fund's Annual Report and Accounts.
- 2.8 The latest version of the ISS was approved by the Panel at its meeting held on 22 February 2019.
- 2.9 At the Panel meeting held on 12 July 2019 the decision was made to change the target benchmark allocations for NCCPF's publicly quoted equities. Report 5 on the private Report of the Service Director – Finance shows the new strategic target allocation to reflect the July Panel decision, and the stage reached in moving assets into the new target proportions.
- 2.10 The third of three tranches of trades to move to the new target allocation will take place on 1 October 2019. Therefore, from 1 October 2019, Legal and General will manage NCCPF's new central benchmark to the new strategic target.
- 2.11 The ISS currently in place reflects the previous asset allocation for NCCPF (with 24% of Fund value in UK equities). With effect from 1 October 2019 a new asset allocation will be in place (with 12% of Fund value in UK equities) and the attached *draft* ISS has now been updated to reflect this.
- 2.12 The updated *draft* ISS from 1 October 2019 is attached as **Appendix 1**. The changes made to the previously reported version include:
- changing the target asset allocations to reflect the decisions made at the July 2019 Panel meeting; and
  - updating the long term expected returns shown (at the end of the ISS) to reflect Mercer's recent assumptions.

#### Approval and consultation

- 2.13 Members are asked to review and approve the updated draft ISS (attached as Appendix 1) for consultation.
- 2.14 The authority must **consult** over the ISS with “persons it considers appropriate”, therefore, following Panel approval for the draft ISS at this meeting, the Fund's participating employers and relevant trade unions will be consulted. This report also seeks delegated authority to the Service Director – Finance, in consultation with the Chair and Vice Chair of the Panel, to amend the ISS, if appropriate, as a result of comments received from the consultation process.
- 2.15 Any **significant** revisions to the ISS, following consultation, will be brought back to the Panel meeting on 6 December 2019, for information.



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### REPORT OF THE SERVICE DIRECTOR - FINANCE

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#### 3. Scheme Advisory Board's review of LGPS governance

##### Purpose of the report

This report provides information about the Scheme Advisory Board's ongoing review of LGPS governance, which is due to conclude later this year.

##### Recommendation

**The Panel is requested to accept the report.**

##### Key issues

- 3.1 In October 2018, the LGPS Scheme Advisory Board (SAB) launched the "**Good Governance Review**". Its purpose was to consider ways of:
  - raising **standards** of governance across the LGPS;
  - ensuring **conflicts of interest** are identified and managed effectively; and
  - ensuring the Scheme remains **appropriately resourced** to deliver its statutory functions and meet regulatory obligations.
- 3.2 In January 2019, the SAB procured assistance from Hymans Robertson (HR) to engage with LGPS stakeholders to explore potential LGPS governance options. HR issued the Good Governance Review online **survey**, which closed on 31 May 2019. The survey included four outline LGPS governance models, summarised in paragraph **3.13**, on which it sought views.
- 3.3 The findings of the survey were reported to the SAB in July 2019. HR's "**Good Governance in the LGPS**" report was then published and is **enclosed** with these papers. The model for which there was most support from respondents was **Option 2**: greater ring fencing of the LGPS within existing structures.
- 3.4 HR made a number of recommendations for the SAB to consider. The recommendations can be summarised as taking an '**outcomes-based**' approach to governance with **minimum standards** rather than prescribing a 'one size fits all' governance model for the LGPS.
- 3.5 For the next stage of the project, the SAB has again invited HR to provide support. Two **working groups** will be established, one each to focus on:
  - defining good governance outcomes and the guidance needed; and
  - options for independent assessment of outcomes and mechanisms to improve the delivery of those outcomes.
- 3.6 Once the SAB is in a position to make recommendations to MHCLG for changes to the regulations or guidance, it will consult with stakeholders on those recommendations. Further updates will be brought to the Panel in due course.

### 3. Scheme Advisory Board's review of LGPS governance

#### BACKGROUND

##### Scheme Advisory Board's Separation Project launched in 2015

- 3.7 In 2015, the newly formed LGPS Scheme Advisory Board (SAB) launched a review, called the "**Operations for separation of host authority and pension fund**". This review was later put on hold while LGPS investment pooling was in its initial stages. This 2015 project, although not completed, had reached the conclusion that only by maintaining the strong link to local democratic accountability provided by the involvement of elected members could the LGPS's statutory nature be effectively maintained.
- 3.8 In October 2018, the LGPS SAB relaunched the project naming it the "**Good Governance Review**" in order to clarify that separation of the pension fund from local authority control was no longer within its remit.

##### The SAB's 2018 Good Governance Review

- 3.9 In January 2019, the SAB procured assistance from Hymans Robertson (HR) to engage with stakeholders to investigate effective governance options for the LGPS.
- 3.10 The **purpose** of the review was to consider means of **raising standards** of governance across the LGPS such that **conflicts of interest** are identified and managed effectively and that the Scheme remains **appropriately resourced** and able to deliver its statutory functions and meet regulatory obligations.
- 3.11 The review was established because of concern that the current legal and regulatory framework could lead to poor standards and unmanaged conflicts of interest.

##### Hymans Roberston's Good Governance Review survey

- 3.12 After some initial fact finding work, HR issued the Good Governance Review **survey** on 17 April 2019, with responses requested by **31 May 2019**. The survey was widely promoted and was open to anyone to participate in.
- 3.13 The survey included four outline LGPS governance models on which it sought views. The four models are described below.

##### 3.13.1 **Option 1: Improved practice**

Under this model there would be guidance issued and/or amendments made to the LGPS Regulations to enhance existing LGPS governance arrangements, for example, SAB guidance could be given on a minimum expected level of staffing.

### 3.13.2 **Option 2: Greater ring fencing of the LGPS within existing structures**

Under this model there would be greater separation of the pension fund management from the host authority, for example, the pensions committee could be required to set the budget for fund expenditure.

### 3.13.3 **Option 3: Use of a Joint Committee (JC)**

Under this model the Scheme Manager function and all decision making would be delegated to a Section 102 JC comprising all the local authorities currently participating in the fund, but with the assets and liabilities remaining the responsibility of the existing administering authority.

### 3.13.4 **Option 4: Use of a Combined Authority (CA)**

Under this model, each fund would be established under an independent structure (a CA) which would be a local authority in its own right and a separate legal entity. The CA's sole purpose would be to administer the fund and it would have no other responsibilities. South Yorkshire Pensions Authority is set up as a CA and is the only example of this in the LGPS in England and Wales.

3.14 In summary, NCCPF's views of the options which were given in its response to the survey were:

- Option 3 would be neither workable nor desirable, as the decision making function is **not aligned** with the responsibility for the fund;
- Options 1 and 2 would both be workable, and since they are not mutually exclusive, the best parts of both options could be combined, with a **comply or explain** type of model adopted; and
- Option 4 is workable but would not be value for money unless there was some consolidation of smaller funds, and, consolidation of funds as a government policy may not sit well with the pooling agenda at this time.

3.15 HR received 140 responses to the online survey and conducted 153 one-to-one conversations. NCCPF participated in both methods of engagement to give its views.

### Results of the survey

3.16 The findings of the survey were reported to the SAB at its meeting held on 8 July 2019. HR's "**Good Governance in the LGPS**" report was then published and is **enclosed** with these papers.

3.17 The results of the responses to the survey showed the **most favoured** governance model of those listed above was **Option 2**.

3.18 Following the survey, HR made a number of recommendations for the SAB to consider. The recommendations can be summarised as taking an '**outcomes-based**' approach to governance with **minimum standards** rather than prescribing a 'one size fits all' governance model for the LGPS.

3.19 In a press release timed to coincide with publication of the report, HR said:

*“After an extensive industry consultation ... it became clear that moving to an outcomes based approach would be the most effective solution. This will allow funds to continue doing what currently works well while still ensuring the highest governance standards across the scheme. The report recommends introducing key benchmarks which will be used to assess each fund ...”*

3.20 In HR’s view, the outcomes-based approach should include:

- robust conflict management including clarity on roles and responsibilities for decision-making;
- assurance on sufficiency of administration and other resources (quantity and competency) and appropriate budget;
- explanation of policy on employer and scheme member engagement and representation in governance; and
- regular independent review of governance based on an enhanced governance compliance statement to explain how the required outcomes are delivered.

3.21 HR has also proposed:

- enhanced training requirements for Section 151 Officers and Section 101 committee members, to put the requirements for committee members on a par with Local Pensions Board members; and
- that central guidance be updated and better sign-posted.

### Comment

3.22 There are no real surprises in the conclusions from the HR report, and there is a clear acknowledgement in it that governance structure is *not* the only determinant of good governance.

3.23 There is nothing within HR’s proposals or conclusions to give NCCPF cause for concern, though it should be noted the HR report *only* makes recommendations and the final outcome may differ from them.

3.24 It should be noted that Option 2 is the most closely reflective of the arrangements already in place at Tyne and Wear Pension Fund, where the administering authority function operates as a semi-autonomous unit within South Tyneside Council.

### Next steps

3.25 For the next stage of the project, the SAB has again invited HR to provide support. Two **working groups** will be established, one each to focus on:

- defining good governance outcomes and the guidance needed; and
- options for independent assessment of outcomes and mechanisms to improve the delivery of those outcomes.

3.26 Both working groups will comprise a wide range of LGPS stakeholders and it is intended that both will report back to the SAB at its next meeting in November 2019. Legal input on the models will then be obtained before the final SAB decisions, which are expected later in 2019.

- 3.27 Once the SAB is in a position to make recommendations to MHCLG for changes to the regulations or guidance, it will consult with stakeholders on those recommendations.
- 3.28 Further update reports will be brought to the Panel in due course.



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## REPORT OF THE SERVICE DIRECTOR - FINANCE

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### 4. CMA proposed changes to the investment consultancy market

#### Purpose of the report

This report provides information about reforms to the investment consultancy market following publication of the CMA Order in June 2019, and the implications for NCCPF.

#### Recommendation

**The Panel is requested to delegate authority to the Service Director - Finance, in consultation with the Chair and Vice Chair of the Panel, to set formal strategic objectives for Mercer before the CMA Order comes into effect on 10 December 2019.**

#### Key issues

- 4.1 On 10 June 2019, the Competition and Markets Authority (CMA) published “*The Investment Consultancy and Fiduciary Management Market Investigation Order 2019*” (“**the Order**”), which places new obligations on service providers and pension schemes relating to fiduciary management (**FM**) and investment consultancy (**IC**) services. The Order, attached as **Appendix 2**, applies to the LGPS and comes into effect on 10 December 2019. The LGPS Advisory Board’s briefing on it is attached as **Appendix 3**.
- 4.2 NCCPF does not currently use FM services, so the requirement within the Order to regularly tender for FM services is not relevant. However there was concern, initially, that LGPS pools were “caught” by the Order and authorities would be required to tender for FM services from the pool companies they own. Since then, CMA and DWP have both indicated, in writing, that this is **not** the intention.
- 4.3 For the LGPS, the “Relevant Sector Regulator” to implement the Order is MHCLG. However, Part 7 of the Order (i.e. the requirement to set objectives for IC) will apply until MHCLG has brought forward provisions in the LGPS on remedy 7. To be prudent, officers have assumed that the requirement to set strategic objectives for investment consultants will apply in the LGPS.
- 4.4 An IC service is the provision of advice, including advice:
  - on which investments are made;
  - the scheme manager is required by law to take;
  - on investment strategy, and
  - on manager selection.
- 4.5 NCCPF must now set strategic objectives for its adviser, Mercer. Draft guidance for setting objectives, issued by the Pensions Regulator, is **enclosed** with these papers. Mercer plans to issue a **model set of strategic objectives** for LGPS clients in the next few weeks which NCCPF will use as its starting point when drafting its own.

## 4. CMA proposed changes to the investment consultancy market

### BACKGROUND

#### CMA's investigations

- 4.6 In September 2017, the Panel received a report about the Financial Conduct Authority's (FCA's) reference to the Competition and Markets Authority (CMA) covering the FCA's concerns over conflicts of interests among investment advisers, and the potential for advisers to encourage clients to move from consultancy to more lucrative "fiduciary management" mandates. The FCA's concerns were over concentration in the market, most notably for Aon, Mercer and Willis Towers Watson.
- 4.7 On 18 July 2018, the CMA published (for consultation) its "Investment Consultants Market Investigation" *provisional* decision report. This concluded that while there is good competition in the market, nevertheless there was scope to improve in both the investment consultancy (IC) and fiduciary management (FM) markets.
- 4.8 In September 2018 the Panel received a report about the CMA's provisional decision report, which concluded that **trustees** would be required to:
- tender for FM services; and
  - set objectives for IC.
- 4.9 The *final* decision report was published by the CMA on 12 December 2018. This concluded that there are competition issues in both the IC and FM markets, with greater concerns arising in relation to the FM market.
- 4.10 On 11 February 2019, the CMA published a draft Order to remedy, mitigate or prevent the adverse effect on competition in connection with the supply and acquisition of IC and FM services to pension schemes which it had identified.
- 4.11 At that stage, it was clear that the draft Order did *not* apply to the LGPS.

#### The IC and FM Order

- 4.12 On 10 June 2019 the CMA published "*The Investment Consultancy and Fiduciary Management Market Investigation Order 2019*" ("**the Order**"), which is attached as **Appendix 2** to this report. The Order places new obligations on service providers and pension schemes with regard to FM and IC services.
- 4.13 In a change which took the LGPS sector by surprise, the **LGPS was brought into scope** in the final Order. The LGPS is now included in the list of schemes the Order applies to, within the definition of trustees and by removing the previous exemption.
- 4.14 The expectation is that the "Relevant Sector Regulator" will implement the Order using terms and expressions that best fit within the applicable regulatory framework, so there will be an opportunity for interested parties to comment on the draft sector-specific provisions.

- 4.15 On 29 July 2019 the DWP published a consultation on implementing the CMA's Order. DWP's implementing regulations do not apply to LGPS funds and DWP notes in its paper that "regulations and guidance in relation to the LGPS are a matter for MHCLG".
- 4.16 It is understood that currently, the Ministry of Housing, Communities and Local Government (MHCLG) is discussing next steps for LGPS funds with the CMA. Therefore, Part 7 of the Order (i.e. the requirement to set objectives for IC) will apply until MHCLG makes regulations and/or guidance which implements remedy 7 into the LGPS.
- 4.17 The Order comes into effect on **10 December 2019**.

#### Scheme Advisory Board briefing

- 4.18 The LGPS Scheme Advisory Board (SAB) has published and updated a briefing note in relation to the Order. The briefing note issued on 1 August 2019 (to replace the note issued on 12 July), is attached as **Appendix 3** to this report.
- 4.19 The SAB briefing note contains the relevant extracts of the Order applicable to the LGPS sector and a Question and Answer narrative exploring the issues applicable to LGPS.
- 4.20 The Order *appeared* to introduce two new requirements on the LGPS:
- to tender for services provided by some pool companies which fall under the definition of FM; and
  - to set strategic objectives for providers of IC services.
- 4.21 Strategic asset allocation is not currently included as a FCA regulatory activity but the service is included in the definition of strategic objectives within the Order. Therefore the Order appears to flag a potential change to bring advice on strategic asset allocation within the definition of a regulated activity, meaning that in the future, only FCA regulated providers may be permitted to give such advice.

#### Does the Order apply to LGPS pooling arrangements?

- 4.22 Initially there were concerns that the Order may apply to LGPS pooling arrangements and administering authorities would be required to tender for FM services from the pool companies which they own. Since then, CMA and DWP have both indicated, in writing, that this is not the intention.
- 4.23 In August 2019, the five LGPS fund-owned pooling companies, including BCPP Ltd, gained written assurance from the CMA that Article 1.7(b) provides that the Order does **not** apply in relation to IC or FM services "*which a scheme receives from a company owned by the trustees of the scheme in question*".
- 4.24 Therefore, at this stage it is viewed as very **unlikely** that NCCPF, as joint owner of BCPP Ltd, will be required by the Order to tender for services provided by BCPP Ltd. However, until the Regulations are drafted and made there must remain some doubt.

## Does NCCPF have fiduciary management arrangements in place?

- 4.25 NCCPF does not have any FM arrangements in place, other than its use of BCPP Ltd's services, and therefore, save for the caveat explained in paragraph 4.24, no tendering of FM services will be required.

## Defining strategic objectives for investment consultancy services

- 4.26 Part 7 of the Order **prohibits** Pension Scheme Trustees (which it defines as including LGPS scheme managers) from entering into a contract or **continuing to obtain** IC services without setting **strategic objectives** for the IC provider.
- 4.27 Part 2 of the Order defines IC services as:

***“Investment Consultancy Services** means the provision to Pension Scheme Trustees of services where the provider advises the Pension Scheme Trustees in relation to one or more of the following:*

- (a) Investments that may be made or retained by or on behalf of the Pension Scheme Trustees;*
- (b) Any matters in respect of which the Pension Scheme Trustees are required by law to seek advice in relation to the preparation or revision of the statement of investment principles;*
- (c) Strategic asset allocation;*
- (d) Manager selection.*

*The reference to ‘advises’ means the provision of advice on the merits of the Pension Scheme Trustees taking or not taking a specific course of action and includes a recommendation or guidance to that effect.”*

- 4.28 Strategic objectives are defined in the Order as:

***“Strategic Objectives** means the objectives for the Investment Consultancy Provider’s advice as applicable by reference to (a) to (d) of the definition of Investment Consultancy Services, in accordance with the Pension Scheme Trustees’ investment strategy.”*

## TPR’s consultation on guidance to implement the CMA Order

- 4.29 On 31 July 2019 the Pensions Regulator (tPR) published a consultation for a draft set of guides for schemes covering the obligations under the Order. These included a guide to **“Setting objectives for providers of investment consultancy services”** which is **enclosed** with these papers.
- 4.30 The enclosed draft guide sets out the legal obligations of schemes, provides examples of IC services and expands on setting objectives. It states:

*“Adviser objectives can be quantitative and qualitative in their nature, for example these could be set in relation to investment performance delivered relative to the liabilities, adviser performance against service level agreements, communication skills, value for money and performance against specific tasks, such as asset transitions or investment manager selection exercises.”*

- 4.31 Setting objectives for advisers is seen as an important part of an effective system of governance by the tPR. TPR expects that by putting objectives in place, trustees will be better positioned to assess the quality of the service they receive.
- 4.32 The CMA's 2018 Investment Consultancy Market Investigation found that trustees had difficulty in monitoring the quality of investment consultancy services due to the limited information available to them. By increasing trustee engagement in the adviser appointment process and by setting objectives and monitoring performance against those objectives, tPR expects that trustees will achieve better outcomes for their schemes and better value for money. By monitoring the investment adviser's performance against objectives trustees will be able to better identify and manage areas of poor performance and to consider switching to an alternate service provider, where appropriate.
- 4.33 The example case studies given by tPR take a balanced scorecard approach to scoring the activities undertaken by the IC provider, with examples of activities which trustees may wish to score, and qualitative as well as quantitative performance measures.

#### Impact on NCCPF

- 4.34 As a result of the Order, NCCPF is required to set strategic objectives for its investment consultant, Mercer, by 10 December 2019.
- 4.35 Mercer must then be assessed by the Panel against the objectives on a regular basis. For some objectives, an annual review may be appropriate, for others such as relating to strategic allocation advice, a longer term may be more appropriate.
- 4.36 Panel members are familiar with the balanced scorecard approach which the Fund applies currently to assessing IC services provided by Mercer. The current NCCPF scorecard is based upon the Pensions and Lifetime Savings Association template. Setting strategic objectives will provide a framework for enhancing this assessment process in the future, with some quantitative targets to evaluate performance against, in addition to the qualitative assessments already in use.

#### Next steps

- 4.37 CMA's inclusion of the LGPS within the scope of the Order, issued in June 2019, was unexpected and the LGPS sector's interpretation of the full implications has been evolving since then. It is anticipated that further information may be issued before the start of December 2019 by MHCLG, tPR, CMA and/or SAB which will inform the framework for setting strategic objectives for IC in an LGPS context.
- 4.38 Mercer plans to issue a **model set of strategic objectives** for LGPS clients in the next few weeks, which NCCPF will use as its starting point when drafting its own. BCPP Partner Fund officers also plan to share information as they each formulate their own objectives for their advisers.
- 4.39 A delegation to the Service Director – Finance, in consultation with the Chair and Vice Chair of the Panel is sought at this meeting, to set NCCPF's strategic objectives for its investment consultant before 10 December 2019. An update report will be brought back to the Panel in due course.

4.40 A statement of compliance certified in accordance with the Order is required to be submitted to the CMA within 12 months of 10 December 2019, and annually thereafter.

# MEETING OF THE PENSION FUND PANEL

20 SEPTEMBER 2019

## REPORT OF THE SERVICE DIRECTOR - FINANCE

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### 5. Consultation on changes to the LGPS actuarial valuation cycle

#### Purpose of the report

This report provides information about the Government's consultation to move the LGPS to a four yearly actuarial valuation cycle.

#### Recommendation

**The Panel is requested to accept the report.**

#### Key issues

- 5.1 In May 2019, MHCLG issued a consultation on changing the actuarial valuation cycle in the LGPS in England and Wales from the current three yearly (triennial) valuations to a four yearly (quadrennial) cycle. The purpose of the change is to move the LGPS to four yearly revaluations to help operate the cost cap mechanism. A four yearly valuation cycle is already in place for the unfunded public service schemes.
- 5.2 The consultation also proposed giving LGPS administering authorities:
- the power to conduct **interim valuations** between formal valuations; and
  - more **flexibility** in managing employer **exits**.
- 5.3 The proposal to change the valuation cycle had been well trailed in advance. From a local funding perspective, the rationale for moving to four yearly is weak, and to some extent this was recognised by MHCLG in the potential mitigations it also proposed, such as interim valuations.
- 5.4 The four LGPS actuarial advisers, Aon, Barnett Waddingham, Hymans Robertson and Mercer, each submitted a comprehensive response to the consultation pointing out the flaws in the proposals. All were in favour of the additional flexibilities but against moving the LGPS to a four yearly cycle. Aon's response to the consultation is attached as **Appendix 4**.
- 5.5 Following consultation with the Chair and Vice Chair of the Panel, a response was submitted, before the end of July deadline, on behalf of NCCPF which **endorsed** Aon's response. It made the additional point that it would be hard *not* to question whether the cost cap process **will remain** a feature of public service schemes by the time the LGPS cycle has been brought in line with the unfunded schemes (in 2024), and whether the proposed changes will be relevant by then.
- 5.6 The proposals have no impact on the 2019 actuarial valuation process.



## MEETING OF THE PENSION FUND PANEL

20 SEPTEMBER 2019

### REPORT OF THE SERVICE DIRECTOR - FINANCE

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#### 6. Outcomes of the July 2019 meeting of the NCC LGPS Local Pension Board

##### Purpose of the report

This report provides information to the Panel about outcomes and proposals from the meeting of NCC's LGPS Local Pension Board ("**the Board**") held on 12 July 2019.

##### Recommendation

**The Panel is requested to accept the report.**

##### Key issues

- 6.1 Under the NCC LGPS Local Pension Board's Terms of Reference, the Board is required to meet at least twice a year, and current practice is to meet four times a year. As set out in the remit of the Pension Fund Panel, 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.*"
- 6.2 From its first meeting in July 2015, the Board has made recommendations to the Scheme Manager (i.e. Northumberland County Council as administering authority for the LGPS) for changes to the LGPS administration and governance arrangements. Since September 2017, Board proposals and outcomes from each meeting have been formally reported to the next quarterly Panel meeting via a Report of the Board Chair, to ensure all relevant Board outcomes are captured and considered by the Panel as a separate agenda item.
- 6.3 The most recent Board meeting was held on 12 July 2019 and the Report of the Board Chair from that meeting is attached as **Appendix 5**.
- 6.4 Topics covered by the Board at that meeting included:
- progress to date to issue the 2018/19 Annual Benefit Statements;
  - data improvement plan;
  - recorded breaches and KPIs;
  - risk register;
  - IDR process and recent outcomes from stages 1 and 2;
  - outcomes from the recent National Fraud Initiative exercise; and
  - Hymans Robertson's review of NCCPF's AVC arrangements.
- 6.5 Gerard Moore, independent Chair of the Board, will present the July 2019 Board meeting outcomes and proposals to the Panel at this meeting.



# MEETING OF THE PENSION FUND PANEL

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## REPORT OF THE SERVICE DIRECTOR - FINANCE

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### 7. Recording breaches and data processing: quarterly monitoring

#### Purpose of the report

This report provides information about breaches of the law and data processing in and before the quarter to 30 June 2019.

#### Recommendation

**The Panel is requested to note the information in this report and delegate to the NCC LGPS Local Pension Board to review this information in detail at its meeting on 18 October 2019, and report back to the Panel.**

#### Key issues

- 7.1 Oversight of the LGPS by the Pensions Regulator (tPR) from 1 April 2015 brought with it the requirement for administering authorities to demonstrate their commitment to data maintenance and improvement, and to record and (potentially) report breaches of the law to tPR.
- 7.2 Following implementation of the shared administration service with Tyne and Wear Pension Fund (TWPF) in January 2018, information about breaches within the **member administration services** function is reported to NCCPF by South Tyneside Council (STC), and breaches within the functions retained by NCC, including collection of contributions, are reported by NCC officers.

#### Breaches within functions retained by NCC

- 7.3 In the quarter to 30 June 2019, one employer breached the requirement to pay contributions due to NCCPF within 19 (or 22) days of the end of month in which they were deducted. Details of the resulting breach are shown in **Appendix 6**.

#### Breaches within member administration services

- 7.4 Breaches information within member administration services for the quarter and year to June 2019 is included in the **enclosed “NCC Pension Fund process details”** (on A3 paper). Officers of TWPF and NCCPF are working together to develop performance and breaches recording information for both funds. Input from the NCC LGPS Board is an integral part of this development work. The enclosed information is the equivalent of the KPIs which were provided to the Panel prior to implementation of the shared service, but much enhanced because it covers all administration processes, rather than just five of them.
- 7.5 This report proposes that the Board be requested to review the attached and enclosed information in detail at its next meeting on 18 October 2019.



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## REPORT OF THE SERVICE DIRECTOR - FINANCE

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### 8. Tyne and Wear Pension Fund's quarterly regulatory report

#### Purpose of the report

This report provides Tyne and Wear Pension Fund's most recent quarterly regulatory report, which is prepared for the Panel and South Tyneside Council's Pensions Committee to keep members up to date with relevant LGPS regulatory changes.

#### Recommendation

**The Panel is requested to accept the report.**

#### Key issues

8.1 Tyne and Wear Pension Fund (TWPF) takes a report ("the regulatory report"), each quarter, to update its Pensions Committee on relevant LGPS regulatory changes and other related matters. The regulatory report is also brought to the Panel, and attached as **Appendix 7** to this report.

8.2 Items of particular note in the regulatory report:

- |                                 |  |
|---------------------------------|--|
| Appendix 7<br>26 September 2019 | <ul style="list-style-type: none"><li>• MHCLG's consultation on changes to the local valuation cycle</li><li>• Update on HMT's Guaranteed Minimum Pension (GMP) consultation</li><li>• The Scheme Advisory Board's (SAB) Good Governance Review</li><li>• Updates on the SAB's ongoing reviews of academies in the LGPS and "tier 3" employers</li><li>• Update on public sector Exit Payment Reforms (the £95,000 cap)</li><li>• Updates on the cost cap mechanism and the McCloud judgement</li><li>• Update on MHCLG's consultation on Fair Deal</li><li>• CMA review of Investment Consulting and Fiduciary Management</li></ul> |
|---------------------------------|--|

8.3 All of the items noted in 8.2 above are covered elsewhere on these papers, or have been covered in previous reports (report 3 for the Good Governance Review; report 4 for CMA review; and report 5 for the change to the valuation cycle).

#### Scheme Advisory Board's July 2019 meeting summary

8.4 SAB has recently implemented an improvement to communications with LGPS administering authorities by distributing a brief summary of the most recent SAB Board meeting. The most recent summary, for the SAB Board meeting held on 8 July 2019, is attached as **Appendix 8**.



## MEETING OF THE PENSION FUND PANEL

20 SEPTEMBER 2019

### REPORT OF THE SERVICE DIRECTOR - FINANCE

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#### 9. Fund performance and total Fund value

##### Purpose of the report

The purpose of this report is to provide information to the Panel about NCCPF's performance in the quarter to 30 June 2019 and the total Fund value at that date.

##### Recommendation

**The Panel is requested to accept the report.**

##### Key issues

- 9.1 The total Fund value (externally managed) was **£1,474** million as at 30 June 2019, compared to £1,428 million as at 31 March 2019, reflecting the positive investment returns over the quarter.
- 9.2 Performance for the Fund as a whole was **3.5%** for the quarter and 3.5% for the year to 30 June 2019, underperforming the Fund's benchmark returns for the quarter of **3.6%** and the year of 3.6%.
- 9.3 Outperformance from Wellington (the Fund's active bonds manager), and Antin (infrastructure manager) was offset by underperformance by all private equity investments, GIP (infrastructure manager) and BlackRock (property manager) during the quarter.
- 9.4 Further detail of annual and quarterly performance by manager and asset class for the period ending 30 June 2019 (i.e. the "**Quarterly Risk and Return Analysis**" provided by Portfolio Evaluation Ltd, the Fund's performance measurement service provider) is **enclosed** with these papers.
- 9.5 Nick Kent of Portfolio Evaluation will attend this meeting to present analysis of the Fund's returns for the year to 31 March 2019. His presentation for this meeting is **enclosed** with these papers.

## 9. Fund performance and total Fund value

### BACKGROUND

#### Total Fund value

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

	as at <u>30 September</u> <u>2018</u> £m	as at <u>31 December</u> <u>2018</u> £m	as at <u>31 March</u> <u>2019</u> £m	as at <u>30 June</u> <u>2019</u> £m
<b>Legal and General</b> <i>Index tracker</i>	1,139.99	1,056.37	1,139.10	1,182.48
<b>Wellington</b> <i>Active corporate bonds</i>	104.64	102.85	106.41	109.18
<b>Schroder</b>	28.89	28.95	28.84	28.81
<b>BlackRock</b>	27.26	27.39	27.19	27.00
<i>Property</i> <b>subtotal</b>	<b>56.15</b>	<b>56.34</b>	<b>56.03</b>	<b>55.81</b>
<b>Morgan Stanley</b>	20.55	20.14	20.14	16.83
<b>NB Crossroads</b>	21.46	21.40	21.41	22.48
<b>Pantheon</b>	7.72	8.46	9.80	10.04
<i>Private equity</i> <b>subtotal</b>	<b>49.73</b>	<b>50.00</b>	<b>51.35</b>	<b>49.35</b>
<b>GIP</b>	36.53	38.94	41.16	39.72
<b>Antin</b>	23.09	24.30	24.30	27.55
<b>Pantheon</b>	-	-	9.23	9.42
<i>Infrastructure</i> <b>subtotal</b>	<b>59.62</b>	<b>63.24</b>	<b>74.69</b>	<b>76.69</b>
<b>Total</b>	<b>1,410.13</b>	<b>1,328.80</b>	<b>1,427.58</b>	<b>1,473.51</b>

Note that capital calls and capital repayments have been made during the year to 30 June 2019 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. Capital repayments have been transferred to Legal and General to invest, or when timing can be matched, used to pay other capital calls.

9.7 Further detail of annual and quarterly performance by manager and asset class for the period ending 30 June 2019 (i.e. the “*Quarterly Risk and Return Analysis*” provided by Portfolio Evaluation Ltd, the Fund’s performance measurement service provider) is **enclosed** with these papers.

### Fund performance

9.8 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 2019 and for the latest four quarters. Also shown are the annualised returns achieved by the Fund for the five years to 31 March 2019.

#### 9.9 Annual returns

	Financial year to 31 March				
	2015	2016	2017	2018	2019
	%	%	%	%	%
Fund	13.2	-0.7	24.2	3.4	6.9
Benchmark	13.1	-1.2	24.1	3.3	6.2

#### 9.10 Quarterly returns

	----- 2018/19 -----		-- 2019/20 --	
	Quarter 3 2018 to 30 Sep 2018	Quarter 4 2018 to 31 Dec 2018	Quarter 1 2019 to 31 Mar 2019	Quarter 2 2019 to 30 Jun 2019
	%	%	%	%
Fund	1.6	-5.9	7.2	3.5
Benchmark	1.3	-5.9	7.3	3.6

#### 9.11 Annualised returns

	All Financial Years Ended 31 March		
	2014/19	2016/19	2019
	%	%	%
Fund	9.1	11.2	6.9
Benchmark	8.8	10.8	6.2
	5 years	3 years	1 year

## 9.12 Asset allocation

	<b>Current target allocation</b>	Quarter 1 2019 at 31 Mar 2019		Quarter 2 2019 at 30 Jun 2019	
	<b>%</b>	<b>£m</b>	<b>%</b>	<b>£m</b>	<b>%</b>
<b>Equities</b>					
UK	24.0	349.2	24.4	360.5	24.5
US	7.0	103.6	7.3	109.0	7.4
Europe	7.0	102.6	7.2	109.5	7.4
Japan	3.5	49.7	3.5	51.1	3.5
Asia Pacific ex Japan	3.5	51.1	3.6	54.0	3.7
Emerging Markets	7.0	102.9	7.2	106.7	7.2
RAFI 3000	<u>8.0</u>	116.4	<u>8.1</u>	122.7	<u>8.3</u>
	<b>60.0</b>		<b>61.3</b>		<b>62.0</b>
<b>Bonds</b>					
Index linked	15.0	263.6	18.5	269.0	18.3
Corporate bonds	<u>10.0</u>	106.4	<u>7.5</u>	109.2	<u>7.4</u>
	<b>25.0</b>		<b>26.0</b>		<b>25.7</b>
<b>Illiquids</b>					
Property	5.0	56.0	3.9	55.8	3.8
Private Equity	5.0	51.4	3.6	49.3	3.3
Infrastructure	<u>5.0</u>	74.7	<u>5.2</u>	76.7	<u>5.2</u>
	<b>15.0</b>		<b>12.7</b>		<b>12.3</b>
<b>Cash</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Total</b>	<b>100.0</b>	<b>1,427.6</b>	<b>100.0</b>	<b>1,473.5</b>	<b>100.0</b>

9.13 The Fund remains overweight in long-dated index-linked gilts with 18.3% of Fund value invested at 30 June 2019, against a target weight of 15.0%. Investment returns on these bonds were:

- 2.0% in the quarter ended 30 June 2019;
- 9.1% in the year ended 30 June 2019; and,
- 6.1% (annualised) in the three years ending 30 June 2019.

9.14 Therefore, the Fund's overweight position in index-linked gilts has made a negative contribution to performance in the quarter.

## IMPLICATIONS ARISING OUT OF THE REPORT

This applies to items 1. to 9. (inclusive) in this report

<b>Policy:</b>	None
<b>Finance and value for money:</b>	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.
<b>Human Resources:</b>	None
<b>Property:</b>	None
<b>Equalities:</b>	None
<b>Risk Assessment:</b>	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.
<b>Sustainability:</b>	None
<b>Crime &amp; Disorder:</b>	None
<b>Customer considerations:</b>	None
<b>Consultation:</b>	None
<b>Electoral divisions:</b>	All

## Report sign off

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

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