AGENDA ITEM 4

FALKIRK COUNCIL

Subject: **GENERAL GOVERNANCE MATTERS**
Meeting: **JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**
Date: **10 DECEMBER 2015**
Author: **DIRECTOR OF CORPORATE & HOUSING SERVICES**

1. INTRODUCTION

1.1 This report updates the Board and Committee on miscellaneous matters associated with the business of Falkirk Council Pension Fund.

2. PENSIONS INCREASE

2.1 Public Sector Pensions, such as the Local Government Pension Scheme, are increased annually each April with the increase being based on the rise in the Consumer Price Index (CPI) in the preceding September. The increase in April, 2016 will therefore be based on the CPI for September 2015. However, as this was a negative of -0.1%, there will be no increase for pensioner and deferred pensioner members in 2016. A zero increase last occurred in 2010. Had the increase been, say 1%, this would have added around £450,000 to the annual pensioner paybill.

2.2 The negative CPI also has an impact on active members. With the LGPS now being a career average scheme, the amount of pension earned each year falls to be revalued in line with CPI. However, the negative CPI means that pensions earned in 2015/16 will not attract a revaluation in 2016. Moreover, it remains to be seen whether HM Treasury will seek to apply a negative revaluation or allow the nil revaluation to stand.

3. PROPOSED SCHEME CHANGES

3.1 The Scottish Public Pensions Agency is amending the Scheme rules as follows:

- to ensure that the surviving spouse of a same sex marriage and the surviving partner of a same sex partnership are entitled to the same benefits as couples of the opposite sex, and

- in the event that a scheme employer ceases to have any active members, to allow administering authorities to delay seeking a cessation payment for a period of up to 3 years, provided they have reasonable grounds to think that the employer will have active members within the permitted delay period.

4. SCHEME ADVISORY BOARD

4.1 The Scheme Advisory Board (SAB) is the body with statutory responsibility for providing advice to the Scottish Ministers on the efficient management of the Local Government Pension Scheme. The SAB works in close conjunction with the Scottish Public Pensions Agency to a work plan agreed by the Scottish Ministers. The latest meeting of the SAB was held in Edinburgh on 26 November.

4.2 The key items on the Board's work plan are as follows:

	Work Scheduled	**Target Date**
1.	Agree a strategic approach to the collection of Fund data in order to facilitate a benchmarking exercise	30 April 2016
2.	Complete a review of the structure of the Scottish LGPS.	30 September 2016
3.	Consider how to improve transparency across the Funds in relation to investment decisions	30 September 2016
4.	Provide guidance as necessary across the Scheme on fiduciary duty, taking account of recent evidence and opinion	31 March 2016
5.	Consider issues surrounding cessation valuations (i.e. where an employer is exiting the Scheme)	30 June 2016
6.	Consider the results of various valuation exercises (i.e. national scheme valuation undertaken by GAD and individual fund valuations)	30 November 2016
7.	Review the Scheme Governance arrangements	31 March 2017

4.3 With regard to item 5, the SAB has considered representations from certain Admission Bodies who are concerned that recent cessation valuations may place their organisations in jeopardy. The SAB is sympathetic to these concerns while recognising that it would be unreasonable to expect other employers to meet the cost of these payments. The change to scheme rules set out in 3.1 can be seen as an initial step in providing Funds with more flexibility to deal with cessation circumstances.

4.4 In relation to item 6, the Government Actuary (GAD) is pursuing work on the Cost Cap mechanism whereby it will be necessary to adjust member contribution rates or the benefit accrual rate if the latest scheme cost has varied by more than 2% from the original 2015 costings. So far, GAD has completed an initial analysis of data from each of the 11 Scottish Funds and is broadly satisfied with its reliability.

5. INFRASTRUCTURE – SCOTTISH PARLIAMENT COMMITTEE REPORT

5.1 The Local Government and Regeneration Committee of the Scottish Parliament has recently published its "Report on pension fund investment in infrastructure and city deal spend". The Chief Finance Officer was one of a number of officers from Scottish Funds who gave evidence to the Committee.

5.2 The report examines the extent to which LGPS Funds are making investments in infrastructure within UK/Scotland; the perceived barriers to further infrastructure investment; and whether public policy initiatives could create an environment for fund investment vehicles to be developed.

5.3 The Committee noted that there was no central overview across LGPS (Scotland) as to how fund assets were being allocated. The Committee considered this an omission, albeit recognising that this information was going to be collated by the Scheme Advisory Board.

5.4 The main barriers to greater infrastructure investment were cited by Funds as project and regulatory risk; governance overheads; high fees; expertise and market presence to source and analyse deals; and the investment limits set by the LGPS Investment regulations.

5.5 Whilst recognising the fiduciary duty owed by Funds to their stakeholders and the need to deliver an appropriate rate of return, the Committee urged Funds not take an unnecessarily cautious approach to risk, but to be proactive in seeking out local infrastructure opportunities.

5.6 The Committee was aware of proposals in England and Wales to pool their 89 funds into 6 large wealth funds. The Committee indicated that it was less attracted to this for the Scottish LGPS Funds on the basis that informal collaborations were working well and because there was a willingness to work together for a shared vision and benefit. In this regard, the Committee recognised the efforts made by Strathclyde, Lothian and Falkirk to invest in domestic infrastructure. However, the Committee observed that at present only an estimated 1% of fund assets nationally were allocated to infrastructure and that this was low in consideration of the positive social and economic impact these investments could bring, not to mention the fact that infrastructure's characteristic of low volatility should make it an attractive proposition for fund investment. The Committee exhorted all funds to challenge themselves to explore local infrastructure opportunities, share expertise and work collaboratively.

6. CORPORATE GOVERNANCE MATTERS

6.1 In discharging its obligations as a responsible investor, the Fund is a member the Local Authority Pension Funds Forum (LAPFF). The LAPFF represents the interests of 65 local authority pension funds with combined assets of around £175 billion. Its mission is to promote the highest standards of corporate governance and social responsibility amongst the companies in which member funds invest.

6.2 The LAPFF is supported by PIRC Ltd, who are the Forum's company research and engagement partner. PIRC are also the Falkirk Fund's proxy voting agents and advisers on ESG matters.

6.3 The recent quarter has seen LAPFF highlight the potential risk to portfolios from climate change. In order to limit the average rise in global temperatures to 2°C, it is estimated that CO2 emissions will require to fall 60% by 2050. Against this scenario, governments may be forced to impose carbon taxes with companies facing the full environmental costs of their actions. Asset owners are therefore being encouraged to understand the extent of carbon exposure within their portfolios. Increasingly, Fund Managers will have to respond to questions such as:

- To what extent is carbon risk embedded in their investment process?
- How is ongoing carbon risk measured and managed?

- Has the Manager made any specific commitment to disclosing the carbon footprint of their investment portfolios?

The issue of carbon risk is on the agenda of the forthcoming LAPFF annual conference.

6.4 Q3 has seen the publication of a legal opinion reinforcing LAPFF's view that accounting standards do not adequately reflect UK company law. This misalignment has led to argue that companies transacting on the basis of unrealised profits contributed to corporate mismanagement in the run up to the financial crisis of 2008.

6.5 The following engagement was undertaken by LAPFF during the quarter:

- BT Group regarding lack of auditor rotation
- Vodafone regarding a possible conflict of interest - a newly appointed director had recently worked for the company's auditors
- Trinity Mirror regarding company strategy and phone hacking claims
- John Menzies regarding its health and safety policy in the light of fatalities at Los Angeles International Airport

6.6 A recent study by PIRC into executive pay amongst the companies comprising the Standard and Poor's 500, disclosed that Chief Executive Officer compensation had increased between 2014 and 2015 by an average of 13%. The study showed that the average pay of a CEO was 328 times the average annual pay of a US employee (around $41k). The analysis showed that there was no significant correlation between the generous salaries and company performance. PIRC regularly votes against inappropriate corporate remuneration packages - recent examples being Microsoft, Medtronic, BHP Billiton, Dixons Carphone.

7. PERSONNEL UPDATE

7.1 Claire Watson who, for many years, has been the Fund's client relationship contact at Schroders is moving to a new role within the organisation. Her replacement is Lyndon Bolton who is a client director for a number of local authority funds.

7.2 Linda Selman, the Fund's longstanding investment adviser with Hymans Robertson is retiring shortly. Discussions are underway with Hymans regarding a replacement adviser. It is anticipated that a verbal update will be provided at the meeting.

8. NAME CHANGE FOR NAPF

8.1 The National Association of Pension Funds, of which the Falkirk Fund is a member, is rebranding itself as the Pensions and Lifetime Savings Association (PLSA). Chief Executive Joanne Segars said the move to rebrand was made "because pensions are changing". Ms Segars added: "Just as the lines are blurring between pensions and other forms of savings, between work and retirement, we have to think differently so we can keep helping our members."

9. FUTURE MEETINGS

Pensions Committee & Pensions Board meetings scheduled for 2016 are as follows:

- 11 March 2016
- 23 June 2016
- 22 September 2016
- 8 December 2016

10. RECOMMENDATION

10.1 The Pensions Committee and Pension Board are invited to note the content of this report and comment as appropriate.

pp **Director of Corporate & Housing Services**

Date: 30 November 2015

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LIST OF BACKGROUND PAPERS

NIL