



**AGENDA ITEM**

**3**

**MINUTE**

YUKON FOR ALL

FALKIRK COUNCIL

MINUTE of JOINT MEETING of the PENSIONS COMMITTEE/BOARD held in the MUNICIPAL BUILDINGS, FALKIRK on THURSDAY 10 DECEMBER 2015 at 9.30 A.M.

PRESENT:

Committee:-  
Councillors Falkirk Council:-  
Jim Blackwood  
Steven Carleschi  
Dr Craig R Martin (Convener)

Andrew Douglas, Unison  
Ian McLean, Pensioner Representative

Board:-  
Susan Crook, Unison  
Gordon Laidlaw, Scottish Autism  
Tommy Murphy, GMB  
Jennifer Welsh, SEPA

ATTENDING:

Alastair McGirr; Pensions Manager  
Bryan Smail, Chief Finance Officer  
Antonia Sobieraj, Committee Services Officer

ALSO IN  
ATTENDANCE:

Bruce Miller, Investment Manager and Andrew Imrie, Portfolio Manager, Lothian Pension Fund  
Louise Dodds, Audit Scotland  
William Marshall and Linda Selman, Hymans Robertson  
Anne Marie Gillon and Steven Hay, Baillie Gifford  
Robin Hay and David Moylett, Newton Investment Management

**PE25. CONVENERSHIP OF MEETING**

In terms of Standing Order 12.1, the Clerk presided at the start of the meeting in the absence of the Convener and invited a member of the Committee to take the Chair for the duration of the meeting. Councillor Dr Craig R Martin, Falkirk Council thereafter took the Chair with the consent of members present.

**PE26. APOLOGIES**

Apologies were intimated on behalf of Depute Provost John Patrick and Councillor Tom Coleman, Falkirk Council; Councillor Archie Drummond, Clackmannanshire Council; Councillor Colin Campbell, Stirling Council; Sandy Harrower, UCATT; Herbie Schroder, UNITE; and Ed Morrison, Scottish Children's Reporter Administration's (SCRA).

**PE27. DECLARATIONS OF INTEREST**

No declarations were made.

**PE28. OPENING REMARKS**

Prior to the formal commencement of business, the Chief Finance Officer advised of the impending retirement of Linda Selman, Hymans Robertson as adviser to the Committee, former Panel and Board over many years. The Committee and Board thanked Linda for her sterling support and commitment to the work of the Pension Fund and wished her well for the future.

**PE29. MINUTE**

**Decision**

**The minute of the joint meeting of the Pensions Committee and Board on 24 September 2015 was approved, subject to the amendment at item 3 (PE16) to record that the 31 March 2014 funding level quoted in paragraph 3.4 of the report to the Committee on 26 June 2015 should have been 84.8% and not 86%.”**

**PE30. GENERAL GOVERNANCE MATTERS**

The Committee and Board considered a report by the Director of Corporate and Housing Services presenting an update on various matters associated with the governance of the Falkirk Council Pension Fund.

The areas covered within the report included the following:-

- The Pensions Increase;
- The Proposed Scheme Changes;
- The Local Government Pension Scheme Advisory Board;
- The Scottish Parliament Infrastructure Report;
- The Pensions and Lifetime Savings Association; and
- The Local Authority Pension Fund Forum (LAPFF) of 58 local authority Pension Funds including work relating to the Fund supporting LAPFF as it bid to file a resolution on carbon disclosure at the next AGM of Anglo American.

**Decision**

**The Committee and Board noted the report.**

### **PE31. PENSION FUND - INVESTMENT SUB GROUP UPDATE**

The Committee and Board considered a report by the Chief Finance Officer providing an update on the work of the Sub Group reviewing the Pension Fund's Investment Strategy.

The Pensions Committee had agreed on 26 June 2015 to the establishment of an Investment Strategy Sub Group, the purpose being to review the Fund's Investment Strategy and make appropriate recommendations to the Committee. The Group would take forward a de-risking plan within the context of a wider review of the Strategy.

The Sub Group had to date held four meetings and the minute of the meeting on 2 October 2015 were attached as an Appendix to the report. The next meeting of the Sub Group would be held in late January/early February 2016 when the Group would review the decision taken to date and work towards producing coherent draft proposals.

#### **Decision**

**The Committee and Board noted the report.**

### **PE32. FUND MANAGER PERFORMANCE REVIEW**

The Committee and Board considered a report by the Chief Finance Officer reviewing the overall performance of the Fund and of the undernoted Fund Managers:-

- Aberdeen Asset Management;
- Baillie Gifford (Bond Mandate);
- Baillie Gifford (Diversified Growth);
- Legal and General Investment Management;
- Newton Investment Management; and
- Schroder Investment Management (UK Equities and Property)

#### **Decision**

**The Committee and Board noted the Fund Managers' performance and the action taken by them during the quarter to 30 September 2015, in accordance with their investment policies.**

### **PE33. PRIVATE EQUITY AND ALTERNATIVES UPDATE**

The Committee and Board considered a report by the Director of Corporate and Housing Services on the progress of the Pension Fund's private equity and alternatives investment programme for SL Capital (Standard Life), Wilshire Associates, Grosvenor Capital, M&G, Hearststone and Lothian Co-Investments for the quarter ending 30 September 2015.

## Decision

The Committee and Board noted the progress of the Pension Fund's private equity and alternatives investment programme for the quarter ending 30 September 2015.

The Committee agreed:-

- (1) a further commitment of \$80m to Grosvenor Capital's CIS II Fund; and
- (2) a commitment of £30m to the Fund's collaboration in infrastructure investment with Lothian Pension Fund.

The meeting adjourned at 11.15 a.m. and reconvened at 11.25 a.m., with all those present as per the sederunt.

## PE34. UK INFRASTRUCTURE

The Committee and Board considered a report by the Director of Corporate and Housing Services on the latest developments in identifying options for investing in UK infrastructure projects.

The report provided options for progressing investment in UK infrastructure including:-

- The Fund's commitment is £30m and being envisaged that monies would be invested in approximately 5 or 6 separate projects and providing appropriate diversification across the portfolio;
- That potential investment opportunities were sourced and analysed by the in-house investment team based in Edinburgh;
- That due diligence process included preliminary and final investment review meetings;
- The final investment decision being made by the Chief Finance Officer on a project by project basis; and
- That whilst investments were predominantly UK/Scottish, it is noted that some individual projects may contain a small element of continental European exposure.

The investments during 2015 included approximately 150 infrastructure investment opportunities were entered into the deal pipeline, of which 40 were deemed suitable, meeting the Fund's investment strategy criteria. 27 of these opportunities were rejected, while 9 remain in the deal pipeline. 4 investments were completed in 3 new investments and 1 follow-on investment.

The 3 new investments were classified under the Availability and Regulated risk type and involved assets in the UK (with 2 investments in Scotland). They were forecast to have target net returns of 7-9% per annum and were partially correlated with inflation, structured as single asset funds and led by different external specialist managers, whilst progressed alongside Lothian Pension Fund

## **Decision**

**The Committee and Board noted the report.**

### **PE35. PRESENTATION - BAILLIE GIFFORD**

The Committee and Board received a presentation by Anne Marie Gillon and Steven Hay, Baillie Gifford.

The presentation covered the undernoted:-

- Fund Valuation and Distribution;
- Performance;
- Corporate Bonds;
- Investment - Rates and Currency Positions;
- Diversified Growth Performance and Valuation; and
- Portfolio Positioning.

The Convener thanked Ms Gillon and Mr Hay for their comprehensive presentation.

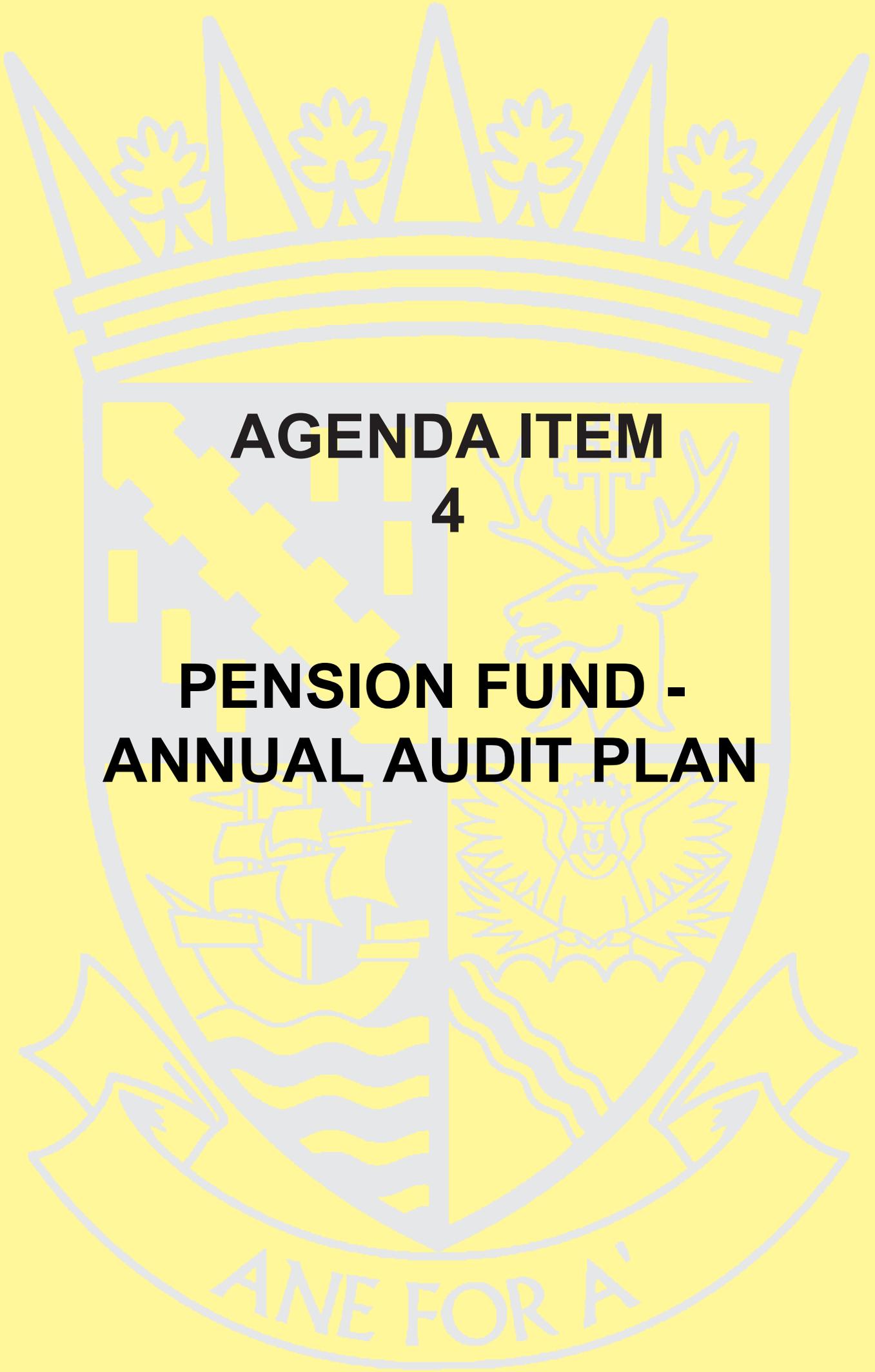
### **PE36. PRESENTATION - NEWTON INVESTMENT MANAGEMENT**

The Committee and Board received a presentation by Robin Hay and David Moylett, Newton Investment Management.

The presentation covered the undernoted:-

- Investment Performance and Performance Attribution;
- Impact of State Intervention;
- Data Revolution;
- Transaction Highlights 2015;
- Portfolio Positioning;
- Investment Outlook;
- Performance Attribution;
- Shaping the Portfolio; and
- Global Equities and opportunities Strategy;

The Convener thanked Mr Hay and Mr Moylett for their comprehensive presentation.



**AGENDA ITEM**

**4**

**PENSION FUND -  
ANNUAL AUDIT PLAN**

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**FALKIRK COUNCIL**

**Subject: PENSION FUND - ANNUAL AUDIT PLAN**  
**Meeting: JOINT MEETING OF PENSION COMMITTEE AND PENSION BOARD**  
**Date: 11 MARCH 2016**  
**Author: DIRECTOR OF CORPORATE AND HOUSING SERVICES**

**1. INTRODUCTION**

1.1 This purpose of this report is to bring the Annual Audit Plan of Audit Scotland to the attention of the Committee and Board.

**2. ANNUAL AUDIT PLAN 2015/16**

2.1 Audit Scotland has submitted its formal plan for the audit of the 2015/16 pension fund annual report and accounts. A copy of the plan is attached as an appendix to this report.

2.2 The key milestones of the audit process are set out on Page 7 of the plan. These include:

23/06/2016 - Consideration of Unaudited Financial Statements by Committee/Board

30/06/2016 - Latest date for Submission of Unaudited Financial Statements

22/09/2016 - Consideration of Audited Financial Statements by Committee/Board

30/09/2016 - Latest date for submission of Audited Financial Statements

30/09/2016 - Latest date for issue of ISA 260 and Annual Audit Report

2.3 Matters identified in the Annual Audit Plan as being of potential risk to the Fund are set out on Pages 13 and 14 of the plan and include Administration Performance, Member Training and Risk Management.

2.4 It is anticipated that the ISA260 (“Communication of audit matters to those charged with governance”) and the Annual Audit Report will form part of the papers for the joint meeting of Committee and Board on 22 September.

2.5 The fee for the 2015/16 audit is £23,010 and is unchanged from 2014/15.

**3. INTERNAL AUDIT WORK**

3.1 Internal Audit’s Audit Plan for the Pension Fund for 2016/17 will be presented to the joint meeting of the Committee and Board on 23 June 2016.

**4. RECOMMENDATION**

- 4.1 Members are asked to note the issuing of the Annual Audit Plan by Audit Scotland, consistent with the audit of the pension fund annual report and accounts 2015/16.**

**PP Director of Corporate and Housing Services**

**Date: 1 March 2016**

**Contact Officer: Alastair McGirr**

**LIST OF BACKGROUND PAPERS**

NIL



# Falkirk Council Pension Fund

Annual Audit Plan  
2015/16

Prepared for Members of Falkirk Council as the  
administering body of Falkirk Council Pension Fund

February 2016

# Key contacts

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The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies ([www.audit-scotland.gov.uk/about/ac/](http://www.audit-scotland.gov.uk/about/ac/)). Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General ([www.audit-scotland.gov.uk/about/](http://www.audit-scotland.gov.uk/about/)).

The Accounts Commission has appointed Fiona Mitchell Knight as the external auditor of Falkirk Council Pension Fund for the period 2011/12 to 2015/16.

This report has been prepared for the use of Falkirk Council Pension Fund and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

# Contents

Summary .....	3
Responsibilities .....	4
Audit approach .....	5
Audit issues and risks .....	9
Fees and resources .....	10
Appendix 1: Planned audit outputs.....	12
Appendix 2: Significant audit risks .....	13

# Summary

## Introduction

1. Our audit is focused on the identification and assessment of the risks of material misstatement in Falkirk Council Pension Fund's financial statements. This is the last year of our five year audit appointment.
2. This report summarises the key challenges and risks facing Falkirk Council Pension Fund and sets out the audit work that we propose to undertake in 2015/16. Our plan reflects:
  - the risks and priorities facing Falkirk Council Pension Fund
  - current national risks that are relevant to local circumstances
  - the impact of changing international auditing and accounting standards
  - our responsibilities under the Code of Audit Practice as approved by the Auditor General for Scotland
  - issues brought forward from previous audit reports.
- the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014 and the 2015/16 Code of Practice on Local Authority Accounting in the United Kingdom (the Code)
- a review and assessment of Falkirk Council Pension Fund's governance and performance arrangements in a number of key areas including: internal controls and adequacy of internal audit
- reporting of National Fraud Initiative arrangements and results
- provision of an Annual Audit Report.
4. We will also attend joint meeting of the Pensions Committee and Pensions Board on a regular basis.

## Summary of planned audit activity

3. Our planned work in 2015/16 includes:
  - An audit of the financial statements and provision of an opinion on whether:
    - they give a true and fair view of the state of affairs of Falkirk Council Pension Fund as at 31 March 2016 and its income and expenditure for the year then ended

# Responsibilities

5. The audit of the financial statements does not relieve management, the Pensions Board or the Pensions Committee, as the body charged with governance, of their responsibilities.

## Responsibility of the appointed auditor

6. Our responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.
7. Auditors in the public sector give an independent opinion on the financial statements. We also review and report on the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs and to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

## Responsibility of the Chief Finance Officer

8. It is the responsibility of the Chief Finance Officer, as the appointed "proper officer", to prepare the financial statements in accordance with relevant legislation and the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). This means:
  - maintaining proper accounting records, and
  - preparing financial statements which give a true and fair view of the state of affairs of Falkirk Council Pension Fund as at 31 March 2016 and its expenditure and income for the year then ended.

## Format of the accounts

9. The financial statements should be prepared in accordance with the Code, which constitutes proper accounting practice.

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# Audit approach

## Our approach

10. Our audit approach is based on an understanding of the characteristics, responsibilities, principal activities, risks and governance arrangements of Falkirk Council Pension Fund. We also consider the key audit risks and challenges in the local government sector generally. This approach includes:
  - understanding the business of Falkirk Council Pension Fund and the risk exposure which could impact on the financial statements
  - assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
  - identifying major transaction streams, balances and areas of estimation and understanding how Falkirk Council Pension Fund will include these in the financial statements
  - assessing and addressing the risk of material misstatement in the financial statements
  - determining the nature, timing and extent of the audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements give a true and fair view.
11. We have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus audit testing on higher risk areas during the audit of the financial statements. The main areas of assurance for the audit come from
  - planned management action and reliance on systems of internal control. Planned management action being relied on for 2015/16 includes:
    - comprehensive closedown procedures for the council and group financial statements accompanied by a timetable issued to all relevant staff
    - the appointment of a Pensions Accountant with clear responsibilities for preparation of financial statements and the provision of supporting working papers
    - delivery of unaudited financial statements to agreed timescales with a comprehensive working papers package
    - completion of the internal audit programme for 2015/16.
12. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. Internal audit services are provided by the Internal Audit section of Falkirk Council. We carried out an early assessment of the internal audit function and concluded that it complies with the main requirements of the Public Sector Internal Audit Standards (PSIAS).
13. We will place formal reliance on aspects of the work of internal audit in relation to Pensions Administration and Pension Fund Governance Arrangements in 2015/16. Internal audit have already completed and reported on this work using 2014/15 transactions for testing purposes. However, our audit approach allows us to place reliance on testing carried out in the previous year.

## Materiality

14. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (e.g. the failure to achieve a statutory requirement or, an item contrary to law). In the event of such an item arising, its materiality has to be viewed in a narrower context; such matters would normally fall to be covered in an explanatory paragraph in the independent auditor's report.
15. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements both individually and collectively.
16. Based on our knowledge and understanding of Falkirk Council Pension Fund we have set our planning materiality at £7.891 million (10% of contributions as per the 2014/15 audited accounts).
17. We set a lower level, known as performance materiality, when defining our audit procedures. This is to ensure that uncorrected and undetected audit differences do not exceed our planning materiality. This level depends on professional judgement and is informed by a number of factors including:
  - extent of estimation & judgement within the financial statements
  - nature and extent of prior year misstatements
  - extent of audit testing coverage.
18. For 2015/16 performance materiality has been set at £3.945 million. We will report, to those charged with governance, all misstatements identified which are greater than £100,000.

## Reporting arrangements

19. The Local Authority Accounts (Scotland) Regulations 2014 require that the unaudited annual accounts are submitted to the appointed external auditor no later than 30 June each year. The Pensions Committee is required to consider the unaudited annual accounts at its meeting on 23 June 2016.
20. Local authorities must publish the unaudited accounts on their websites and give public notice of the inspection period.
21. The 2014 regulations require the local authority (or a committee whose remit includes audit or governance) to meet by 30 September to consider whether to approve the audited annual accounts for signature. Immediately after approval, the annual accounts require to be signed and dated by specified members and officers and then provided to the auditor. The Controller of Audit requires audit completion and issue of an independent auditor's report (opinion) by 30 September each year.
22. The authority is required to publish on its website its signed audited annual accounts, and the audit certificate, by 31 October. The annual audit report is required to be published on the website by 31 December.

23. A proposed timetable for the audit of the 2015/16 financial statements is included at Exhibit 1 below.

### Exhibit 1: Financial statements audit timetable

Key stage	Date
Testing and review of internal control systems and transactions	By April 2016
Meetings with officers to clarify expectations of working papers and financial system reports	By April 2016
Consideration of unaudited financial statements by those charged with governance	23 June 2016
Latest submission date of unaudited council financial statements with complete working papers package	By 30 June 2016
Progress meetings with lead officers on emerging issues	As required during the audit
Latest date for final clearance meeting with Pensions Manager and Pensions Accountant	12 August 2016
Agreement of audited unsigned financial statements, and issue of Annual Audit Report which includes the ISA 260 report to those charged with governance	22 Sept 2016
Independent auditor's report signed	22 Sept 2016

24. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Any reports will be issued to the

responsible relevant officers to confirm factual accuracy. Responses to draft reports are expected within two weeks of submission.

25. A copy of all final agreed reports will be sent to the Chief Executive, Chief Finance Officer, Director of Corporate & Housing Services, Pensions Manager, Internal Audit Manager and Audit Scotland's Performance Audit and Best Value Group.
26. We will provide an independent auditor's report to Falkirk Council Pension Fund and the Accounts Commission that the audit of the financial statements has been completed in accordance with applicable statutory requirements. The combined ISA 260 and Annual Audit Report will be issued by 30 September 2016.
27. All annual audit reports produced are published on Audit Scotland's website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).
28. Planned outputs for 2015/16 are summarised at [Appendix 1](#).

### Quality control

29. International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established as part of financial audit procedures. This is to provide reasonable assurance that those professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.
30. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice issued by Audit

Scotland and approved by the Accounts Commission. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews and has been subject to a programme of external reviews by the Institute of Chartered Accountants of Scotland (ICAS).

31. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We do, however, welcome feedback at any time and this may be directed to the engagement lead, Fiona Mitchell Knight.

## Independence and objectivity

32. Auditors appointed by the Accounts Commission must comply with the Code of Audit Practice. When auditing the financial statements, auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards including an annual “fit and proper” declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland’s Ethics Partner.

33. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of Falkirk Council Pension Fund.

# Audit issues and risks

## Audit issues and risks

34. Based on our discussions with staff, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for Falkirk Council Pension Fund. We have categorised these risks into financial risks and wider dimension risks. The financial statements issues and risks, which require specific audit testing, are summarised below and detail contained in [Appendix 2](#).

## Financial statement issues and risks

35. **Management override of controls** – International Standard on Auditing (ISA) 240 recognises that management are in a unique position and have the ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively. ISA 240 requires that the risk be recognised in audit plans. We will design and perform audit procedures to address these risks with Falkirk Council Pension Fund.

## Wider dimension issues and risks

36. **Administration performance** – A new version of the Scheme operating on a Career Average basis and revised governance arrangements has been effective from 1 April 2015. These arrangements have resulted in an increased workload for the

administration team. Pressures have also been heightened due to unforeseen staff absences, the implementation of a new pensions administration system (Altair), increased queries from members and late year end data returns from employers. A further contributory factor to the higher than normal workload has been the continuous demand for severance estimates reflecting the challenging financial environment faced by Fund employers.

37. As a result, administration performance has deteriorated. There is a risk of regulatory breaches and members may not be able to receive up to date information timeously. Management has advised that temporary staff have been appointed in accordance with the Council's current recruitment and re-deployment policies to alleviate the workload and that key performance information will be included within the Fund's Annual Report.

38. **Members training** – Members of the Pensions Board have a duty to ensure that they maintain sufficient knowledge and understanding of regulatory requirements. This is particularly relevant given the Governance and administration of public service pension schemes Code of Practice no 14 – *governance and administration of public service pension schemes* - issued by the Pensions Regulator (April 2015).

39. Management should make arrangements to assess the skills competencies and knowledge of members and identify any gaps that require to be addressed through further training. Appropriate learning and training records should be maintained to demonstrate steps taken to comply with legal requirements.

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**40. Risk management** – In responding to our 2014/15 Annual Audit Plan management advised us that the Fund’s risk management arrangements would be revisited after the formation of the Pensions Board. It is good practice for the risk register to be reviewed at least annually and to evaluate the internal controls for significant changes. Internal Audit will provide updates to the Pensions Committee on progress made at the year-end.

## Fees and resources

### Audit fee

- 41.** Over the past four years, Audit Scotland has reduced audit fees by 24% in real terms, exceeding our 20% target. Due to further refinement of our audit approach we have been able to maintain audit fees for 2015/16 at the same level as last year. This represents an additional real term fee reduction of 1.6%.
- 42.** In determining the audit fee we have taken account of the risk exposure of Falkirk Council Pension Fund, the planned management assurances in place, and the level of reliance we plan to take from the work of internal audit. We have assumed receipt of a complete set of unaudited financial statements and comprehensive working papers package by 30 June 2016.
- 43.** The proposed audit fee for the 2015/16 audit of Falkirk Council Pension Fund is £23,010. Our fee covers:

- the costs of planning, delivering and reporting the annual audit including auditor’s attendance at committees
- your organisations allocation of the cost of national performance studies and statutory reports by the Auditor General for Scotland
- a contribution towards functions that support the local audit process (e.g. technical support and coordination of the National Fraud Initiative), support costs and auditors’ travel and subsistence expenses.

**44.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

### Audit team

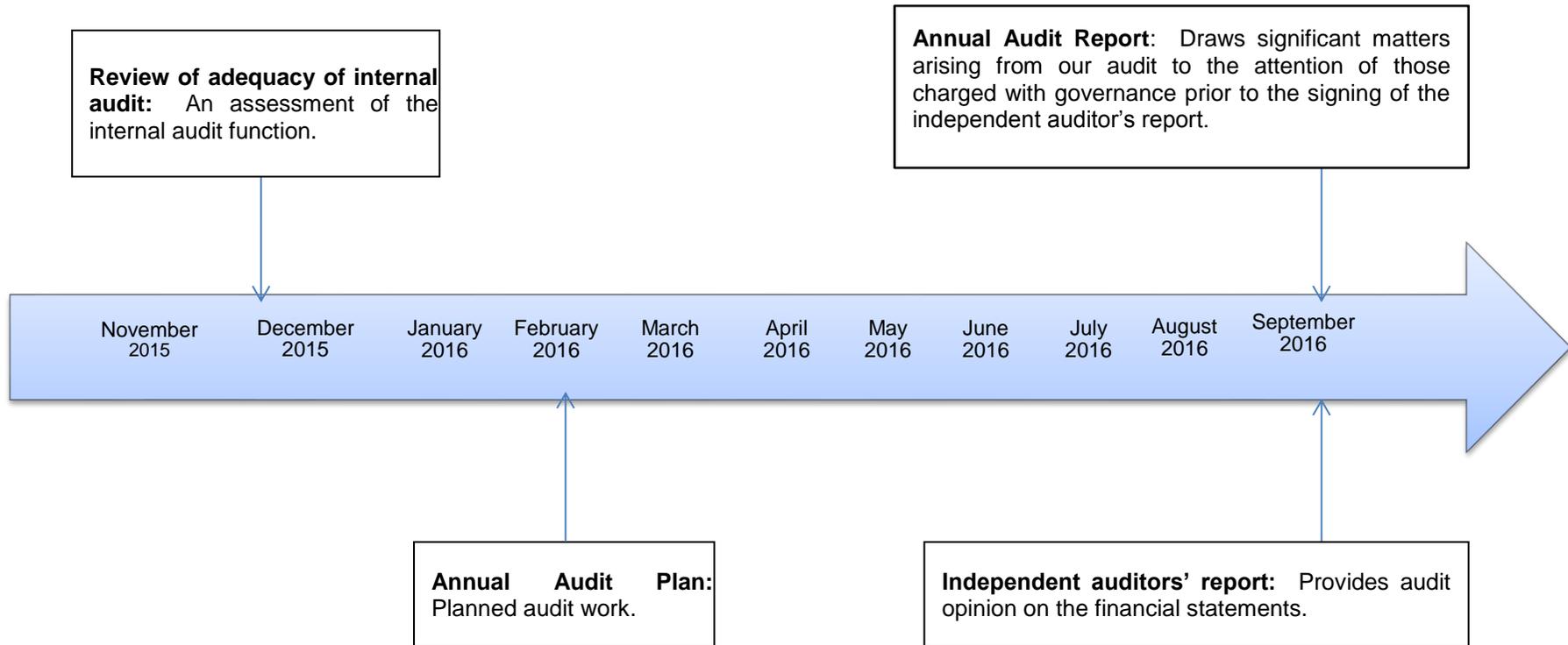
**45.** Fiona Mitchell Knight , Assistant Director, Audit Services is your appointed auditor. The local audit team will be led by Jim Rundell who will be responsible for day to day management of the audit and who will be your primary contact. Details of the experience and skills of our team are provided in Exhibit 2. The core team will call on other specialist and support staff as necessary.

**Exhibit 2: Audit team**

Name	Experience
Fiona Mitchell-Knight, BA (Hons), FCA Assistant Director (and certifying auditor)	Fiona has been an Assistant Director of Audit Scotland since 2007, following 6 years as the Senior Audit Manager for a number of local authority bodies including Glasgow City Council. Fiona trained as an auditor in the private sector in England, and has over 20 years' experience of public sector audit with Audit Scotland, covering local government, health and the further education sectors.
Jim Rundell, MA (Hons), CPFA, Senior Audit Manager	Jim has 31 years public sector audit experience mostly in the local government and health areas. He has worked in a variety of audits including City of Edinburgh Council, NHS Greater Glasgow, Shetland Islands Council, NHS Grampian and Highland Council. Jim has been a Senior Audit Manager for 18 years. He is also a member of Audit Scotland's Performance and Risk Management Group and is responsible for maintaining and updating the Audit Services risk register.
Louise Dodds, BA (Hons), Auditor	Louise joined Audit Scotland in 2011 as part of the professional trainee graduate scheme having studied accountancy at Glasgow Caledonian University. Her experience with Audit Scotland has primarily covered local government and health sectors. Also, in 2014/15 Louise was part of the core audit team that carried out the audit of Falkirk Council Pension Fund.
Toby Freer, BA (Hons), Auditor	Toby has worked on varied Central Government audits since joining Audit Scotland in October 2012. He is at the final stage of qualification for the Institute of Chartered Accountants of Scotland (ICAS). More recently he has been involved in local government and health audits. Furthermore, he provided support to the audit team undertaking the Falkirk Council Pension Fund audit in 2014/15.

# Appendix 1: Planned audit outputs

The diagram below shows the key outputs planned for Falkirk Council Pension Fund in 2015/16.



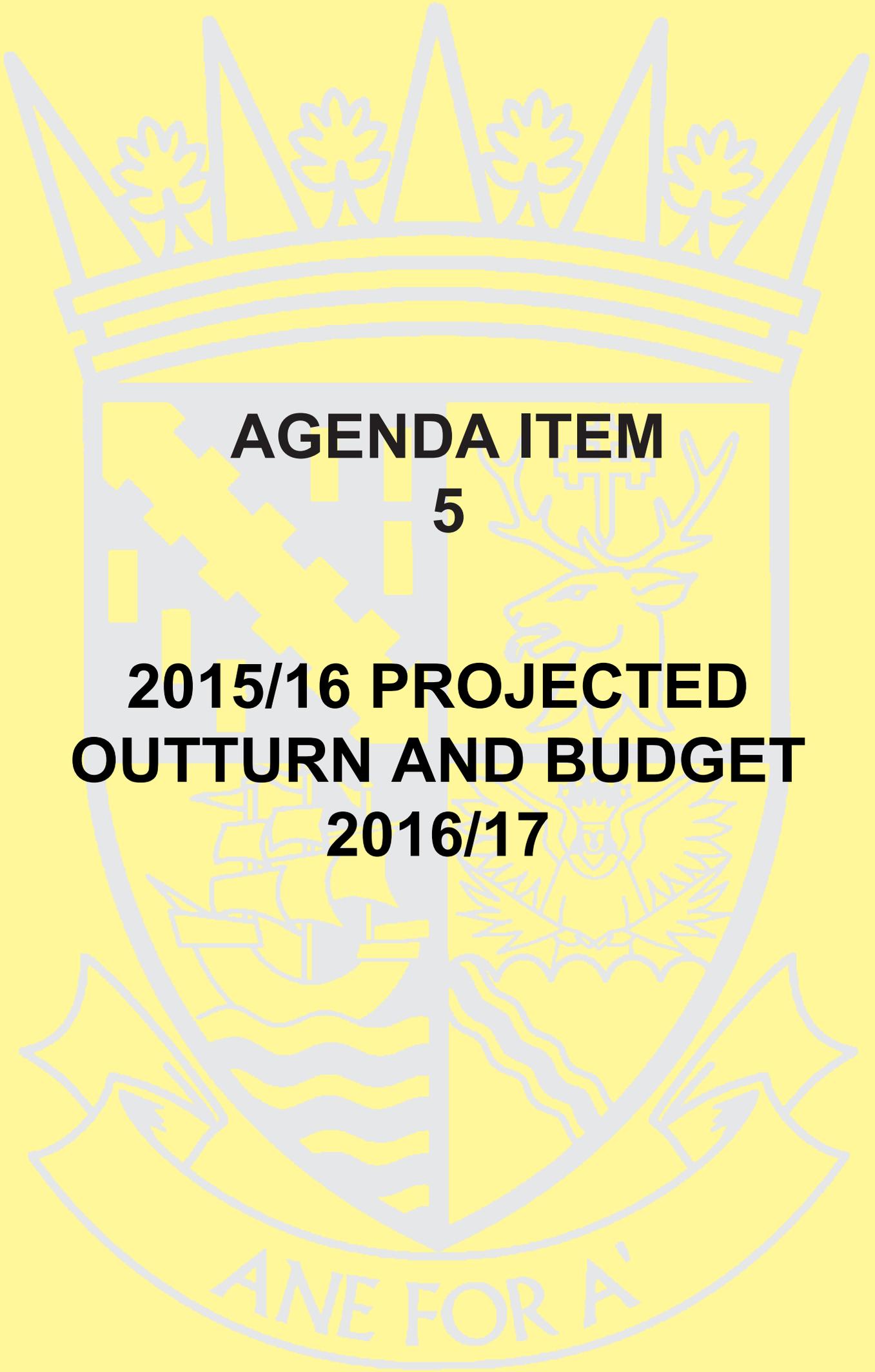
## Appendix 2: Significant audit risks

The table below sets out the key audit risks, the related sources of assurance received and the audit work we propose to undertake to address the risks during our audit work.

#	Audit Risk	Source of assurance	Audit assurance procedure
<b>Financial statement issues and risks</b>			
1	<p><b>Management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> <li>• Scrutiny of financial statements by the Pensions Committee.</li> <li>• Quarterly performance reports to the Pensions Committee &amp; Board by fund managers.</li> <li>• Reports from the Pension Fund Custodian.</li> </ul>	<ul style="list-style-type: none"> <li>• Detailed testing of journal entries.</li> <li>• Review of accounting estimates for bias.</li> <li>• Evaluating any significant transactions that are outside the normal course of business.</li> <li>• Focused testing of regularity and cut-off assertions during the financial statements audit.</li> </ul>
<b>Wider dimension issues and risks</b>			
2	<p><b>Administration performance</b></p> <p>Staff absences and increased administrative duties have resulted in a backlog of work and deterioration of overall performance.</p> <p>There is a risk of possible breaches with regulatory administration requirements and members may not be able to retrieve requested information timeously.</p>	<ul style="list-style-type: none"> <li>• Appointment of temporary staff.</li> <li>• Engagement with employers to ensure timeous data returns.</li> <li>• Prioritisation of workload to minimise any risk of non-compliance with regulatory deadlines.</li> <li>• Continuous monitoring and recording of administration performance and reporting</li> </ul>	<ul style="list-style-type: none"> <li>• Review of arrangements for monitoring potential breaches.</li> <li>• Review of administration performance indicators and comparison against previous year.</li> </ul>

#	Audit Risk	Source of assurance	Audit assurance procedure
		potential breaches to the Pensions Board / Committee.	
3	<p><b>Members training</b></p> <p>Management should assist individual Pensions Board members to determine the degree of knowledge and understanding that is sufficient for them to effectively carry out their role, responsibilities and duties.</p> <p>Records of members training should be maintained to demonstrate steps taken to mitigate any skills and knowledge gaps and to comply with legal requirements.</p>	<ul style="list-style-type: none"> <li>Members' attendance at pension related conferences / seminars.</li> <li>Officer and Adviser presentations to the Pensions Board and Committee.</li> <li>Recording of members training in year in training log.</li> <li>Update Training Policy.</li> </ul>	<ul style="list-style-type: none"> <li>Attendance at Committees / Boards.</li> <li>Review of individual committee attendance and training logs.</li> <li>Consistency reviews of Governance disclosures within Annual Report and Accounts.</li> </ul>
4	<p><b>Risk management</b></p> <p>The core risk register should be updated as part of an overall review of risk management arrangements.</p> <p>Effective risk management arrangements are required to deliver strategic and operational objectives.</p>	<ul style="list-style-type: none"> <li>Review of risk management arrangements.</li> <li>Update central risk register and Statement of Investment Principles.</li> <li>Continued regular reporting of changes in risk profiles to the Pensions Committee.</li> </ul>	<ul style="list-style-type: none"> <li>Discussions with Internal Audit on follow-up work.</li> <li>Review of disclosures within Annual Report and Accounts.</li> </ul>





**AGENDA ITEM**

**5**

**2015/16 PROJECTED  
OUTTURN AND BUDGET  
2016/17**

FALKIRK COUNCIL

Subject: 2015/16 PROJECTED OUTTURN AND BUDGET 2016/17  
Meeting: JOINT MEETING OF PENSIONS COMMITTEE AND PENSION BOARD  
Date: 11 MARCH 2016  
Author: DIRECTOR OF CORPORATE AND HOUSING SERVICES

**1. INTRODUCTION**

- 1.1 This report provides the Pensions Committee and Pension Board with an estimate of the expected outturn for 2015/16 and details of the proposed Fund budget for 2016/17. This is in line with the recommendation from Audit Scotland for a Fund budget to be presented to the Pensions Committee and for performance against budget to be reported.

**2. ESTIMATED OUTTURN AND DRAFT BUDGET**

- 2.1 The estimated outturn and draft budget are as detailed below:

	Budget for 2015/16	Expected Outturn for 2015/16	<i>Variance</i> <i>15-16</i>	Budget for 2016/17
<b>Benefits Administration Costs</b>				
Employee Expenses	321,460	296,590	(24,870)	325,460
Pensions Administration System	400,000	320,000	(80,000)	250,000
Other	75,950	75,850	(100)	77,670
	<b>£797,410</b>	<b>£692,440</b>	<b>£(104,970)</b>	<b>£653,130</b>
<b>Oversight &amp; Governance Costs</b>				
Lothian Collaboration	120,000	150,000	30,000	120,000
Actuarial Fees	40,000	40,000	-	90,000
Tax Advice and Legal Fees	60,000	57,000	(3,000)	100,000
Employee Expenses	96,020	88,590	(7,430)	97,210
Investment Advisory	80,000	80,000	-	90,000
Other	59,710	54,070	(5,640)	61,620
	<b>£455,730</b>	<b>£469,660</b>	<b>£13,930</b>	<b>£558,830</b>
<b>Investment Management Costs</b>				
Managers Fees	5,040,280	5,047,980	7,700	5,655,000
Custodian Costs	120,000	120,000	-	120,000
Aborted Deal Costs	0	0	-	150,000
	<b>£5,160,280</b>	<b>£5,167,980</b>	<b>£7,700</b>	<b>£5,925,000</b>
<b>Pension Fund Total</b>	<b>£6,413,420</b>	<b>£6,330,080</b>	<b>£(83,340)</b>	<b>£7,136,960</b>

### **3. 2015/16 PROJECTED OUTTURN**

- 3.1 Overall, pension fund expenditure for 2015/16 is projected to have a small underspend of £83k (1.3% of the total budget). The main contributor to this is the lower than expected spend on the Pension Administration System. This is due to consultancy work being less than anticipated.
- 3.2 The most significant area of expenditure remains investment management fees, projected to be broadly in line with the budget for 2015/16.

### **4. 2016/17 DRAFT BUDGET**

- 4.1 The budget for 2016/17 has been increased by £723k, mainly attributable to investment management fees.
- 4.2 The investment management fee budget for 2016/17 is £615k higher than the 2015/16 figure having been based on an average of fees over the past 3 years. Due to the fact that fees are levied on the net asset value of investments, it should be noted that they will inevitably vary from budgeted figures as markets rise and fall.
- 4.3 A budget of £150k has been created within Investment Management expenditure to cover the potential costs of due diligence arising from any unsuccessful bids for UK infrastructure investments.
- 4.4 Benefits Administration costs and Oversight and Governance costs have collectively been budgeted to have a small reduction of £41k (from £1,253k to £1,212k). Whilst Pension Administration System costs are expected to reduce as a result of the new system implementation being well advanced, other areas of expenditure such as tax advice and legal fees are expected to increase depending on the outcome of the investment strategy review. Actuarial fees have been returned to the 2014/15 level in anticipation of preparatory work for the 2017 valuation.
- 4.5 Performance against the budget will be reported at half year and again at year end.

### **5. RECOMMENDATION**

- 5.1 **The Pension Committee and Pension Board are asked to note the draft pension fund budget for 2016/17 and estimated outturn for 2015/16; and**
- 5.2 **The Pensions Committee is asked to approve the budget for 2016/17.**

**Director of Housing and Corporate Services**

**Date: 01 March 2016**

**Contact Officer: Alastair McGirr**

#### **LIST OF BACKGROUND PAPERS**

NIL



The background of the page features a large, light blue watermark of the City of Edinburgh's coat of arms. The coat of arms is a shield divided into four quarters. The top-left quarter shows a castle tower, the top-right shows a stag's head with antlers, the bottom-left shows a three-masted sailing ship on the sea, and the bottom-right shows a bird with its wings spread. Above the shield is a crown with four fleurs-de-lis. Below the shield is a ribbon with the motto 'ANE FOR A'.

**AGENDA ITEM**

**6**

**PENSION FUND –  
RISK REGISTER**

ANE FOR A'

FALKIRK COUNCIL

**Subject: PENSION FUND – RISK REGISTER**  
**Meeting: JOINT MEETING OF PENSION COMMITTEE AND PENSION BOARD**  
**Date: 11 MARCH 2016**  
**Author: DIRECTOR OF CORPORATE AND HOUSING SERVICES**

**1. INTRODUCTION**

1.1 This report invites the Pensions Committee to approve a revised risk register for the Fund.

**2. BACKGROUND**

2.1 The format of the current risk register was agreed by the Pensions Committee in June 2013. At that time, it was recognised that Fund management inherently involved risk and that there was a need to manage the various risks surrounding Fund activities.

2.2 Whilst it is not realistic to remove all risks from pension fund operations, a risk register can act as a basis through which Fund risk can be identified, analysed, evaluated and monitored. From that, a number of risk containment strategies may be developed.

2.3 An internal audit review of Fund Governance arrangements has recommended that the risk register be updated to further incorporate investment risk and, where the level of a risk has changed, to report the scale of the change and not merely the change event itself. External Audit have also indicated in the 2015/16 Audit Plan that the central risk register should now be updated.

**3. RISK REGISTER**

3.1 The objectives of the Risk Register are to bring areas of potential risk to the attention of the Committee/Board and enable due consideration to be given to each of the risks, all with a view to safeguarding the interests of Fund stakeholders. Once compiled, the register can act as a central reference point for future Committee/Board meetings.

3.2 The maintenance of a risk register should be seen as part of the Fund's ongoing risk management processes. It should also assist the Committee and Board in identifying risks which can be tolerated compared to those which need to be more closely managed.

3.3 The risk register requires the following processes to be undertaken:

- Identify key risks to Fund objectives
- Evaluate the potential impact of risks
- Manage risks through mitigating controls
- Monitor changes in risks both new and existing
- Monitor the adequacy of existing controls

3.4 The process for evaluating each risk involves considering:

- the likelihood of a risk materialising; and
- the severity of the consequences if it does materialise.

By allocating a value (i.e. 1 - 10) to these elements, it is possible to obtain a “score” for each risk with the highest scores denoting the areas of highest risk.

3.5 It is normal for the risk register to record the risk score both before and after mitigating controls have been applied. This enables the effectiveness of the mitigation to be assessed.

3.6 The Pensions Regulator strongly encourages the use of a risk register as a means of Trustees seeking to ensure that adequate controls are in place and are being implemented.

#### **4. MATTERS ARISING**

4.1 Of the Fund’s currently identifiable risks, those with the highest rating (i.e. most risky) are as follows:

- Funding position affected by falling asset values or falling bonds yields
- Investment Strategy is inappropriate
- Investment risk not adequately quantified
- Failure to meet statutory deadlines
- Incomplete member records
- Failure to migrate pensioner payroll to new platform

4.2 The first three bullet points, which are investment related, could depress fund performance and lead to rises in employer contribution rates. The Committee will be aware of these risks from previous adviser briefings. Additionally, proposals relating to investment strategy will be outlined in a subsequent report at this meeting.

4.3 The latter three bullets reflect the fact that ever higher standards of administration are being demanded by the Pensions Regulator with various infringements having to be reported.

4.4 Key areas of risk identified by External Audit in their 2015/16 Audit Plan, namely the override of management controls, administration performance and Member training are amongst the risks identified in the updated risk register.

## **5. CONCLUSION**

- 5.1 Falkirk Council is responsible for the management of a pension fund with assets of over £1.7bn. The Fund is also responsible for the pension rights of roughly 28,000 scheme members, around 9,000 of whom rely on the Fund for their monthly pension payments. Additionally, the Fund has regulatory and legislative obligations to meet. Failure to deliver the service efficiently could have an adverse effect on many of the Fund's stakeholders and result in significant reputational damage.
- 5.2 Given the Fund's responsibilities, it is right and proper that risks are regularly identified and brought to the attention of those charged with scheme governance. The maintenance of a risk register is considered an appropriate way to meet this requirement.

## **6. RECOMMENDATION**

- 6.1 **The Pensions Committee and Board are asked to note the contents of the report and invited to comment as appropriate.**
- 6.2 **The Committee is asked to approve the revised risk register and to request the Director of Housing and Corporate Services to report any changes to the register on a regular basis**

pp **Director of Corporate & Housing**

**Date: 23 February 2016**

**Contact Officer: Alastair McGirr**

### **LIST OF BACKGROUND PAPERS**

NIL



**Falkirk Council**

*Corporate & Housing Services*

# **Falkirk Council Pension Fund**

## **Local Government Pension Scheme**

### **Risk Register**

# Falkirk Council Pension Fund - Risk Register

## 1. Objectives

The objectives of the Risk Register are to:-

- identify key risks that could prevent the achievement of the Fund's objectives
- evaluate the significance of the risks;
- identify any mitigating controls;
- identify the owner of each risk; and
- act as a basis by which the risks can be monitored and reported upon.

## 2. Risk Assessment

Identified risks are assessed separately and for each the following is determined:-

- the **likelihood** of the risk materialising; and
- the **impact**/potential consequences if it does occur.

## 3. Risk Evaluation

Risks are evaluated on a sliding scale of 1-10 with 10 the highest value i.e. highest likelihood / most severe impact / consequences. The risk evaluation tables overleaf have been used in order to assess specific risks and to introduce a measure of consistency into the risk assessment process. The overall rating for each risk is calculated by multiplying the likelihood value against the impact value to give the total score. The risk rating scores are then used to prioritise the risk rating which is shown in the register itself.

## Risk Evaluation Criteria

The Risk Evaluation Tables: Likelihood	
1	Has never happened to any funds
2	Negligible never happened to the Fund but is theoretically possible
3	Extremely unlikely within the next 3 years, but possible within a 10 year cycle
4	Extremely unlikely within the next 12 months, but possible within a 5 year cycle
5	Unlikely within the next 12 months, but possible within a 5 year cycle
6	Feasible within the next 12 months, and probable within a 3 year cycle
7	Feasible within the next 12 months
8	Probable within the next 12 months
9	Almost certainly expected within the next 12 months
10	Inevitable within the next 12 months

The Risk Evaluation Tables: Impact	
1	None
2	Negligible
3	Minor and easily contained
4	Noticeable short term impact
5	Disruptive for a short period but can be contained with support
6	Potentially significant – threat which could cause some damage in the short-term
7	Significant – potential to cause significant damage in the short and medium term without threatening the survival of the Fund
8	Could seriously threaten Fund reputation or weaken its capacity to survive
9	Significant threat to the survival of the Fund
10	Catastrophic

## Leading 20 Pension Fund Risks (highest risk first)

Risk Ranking	Risk	Mitigated Risk Rating
1	Funding position affected by falling asset values or falling bonds yields	35
2	Investment Strategy is inappropriate	35
3	Failure to meet statutory deadlines (e.g. benefit statements)	35
4	Members' confidential data is lost or made public. Breach of Data Protection Act	35
5	Investment Risk (equity, interest rate, currency and credit risk) has not been adequately assessed.	30
6	Incomplete Member records (e.g. service, contributions, pay)	28
7	Failure to migrate the pensioner payroll to new platform	24
8	Manager under performs or performance monitoring is ineffective	24
9	Committee and Board members have inadequate knowledge and understanding	24
10	Asset Values affected by Political uncertainty	24
11	Under funding leading to pressure on employer contributions	20
12	Failure of IT Systems	20
13	Recruitment and retention of key staff	20
14	Investment Managers may not have appropriate control framework in place	20
15	Staff error or inability to carry out duties in compliance with scheme rules	18
16	The collapse of an Employer body member, leading to pressure on other employers	16
17	Business continuity issues (accommodation, pandemics, etc)	16
18	Decisions influenced by possible conflicts of interest or not in the best interests of stakeholders	15
19	Contributions to the Fund are not received, processed or recorded completely and accurately	12
20	Scheme benefits incorrectly claimed following a pensioner death	12

# Falkirk Council Pension Fund Risk Register

1<sup>st</sup> February 2016

No.	Category	Risk	L	I	Risk Score	Assigned to	Mitigating Controls in Place	L	I	Current Risk	Comment	Review by
A	General	Existing controls not operating effectively	5	7	35	Pensions Manager	<ul style="list-style-type: none"> <li>Risk register used to record risks and document controls</li> <li>Disclosure of risk management activities in annual report</li> <li>Internal controls developed to mitigate identified risk</li> </ul>	3	4	12	<ul style="list-style-type: none"> <li>Risk updates provided to Pensions Committee and Board</li> </ul>	31-Mar-2018
B	Funding	Under funding leading to pressure on employer contributions	7	6	42	Pensions Manager	<ul style="list-style-type: none"> <li>Regular actuarial valuations &amp; inter valuation monitoring</li> <li>Stabilisation strategy in place</li> <li>Contribution flow monitored by Officers</li> <li>Biggest risk lies with smallest employers</li> </ul>	5	4	20	<ul style="list-style-type: none"> <li>Contribution rates set until 2018</li> </ul>	31-Mar-2018
C	Funding	The collapse of an Employer body member, leading to pressure on other employers	6	6	36	Pensions Manager	<ul style="list-style-type: none"> <li>Robust Admissions Policy including use of guarantees and indemnities</li> <li>Regular contact with existing employers to review on-going covenants</li> <li>Strong engagement with employers</li> <li>Some Guarantees/Bonds in place</li> </ul>	4	4	16	<ul style="list-style-type: none"> <li>There has been no exit by an employer from the Fund in the past 30 years without an exit payment being made</li> </ul>	31-Mar-2018
D	Funding	Contributions to the Fund are not received, processed or recorded completely and accurately	7	5	35	Pension Fund Accountant	<ul style="list-style-type: none"> <li>Monthly monitoring of contributions</li> <li>Annual Contribution Reconciliation and Validation with member records</li> <li>Internal/External audit overview</li> <li>Threat of employer being reported to Regulator</li> </ul>	4	3	12	<ul style="list-style-type: none"> <li>No comment</li> </ul>	31-Mar-2018
E	Funding	Funding position affected by falling asset values or falling bonds yields	7	7	49	Pensions Manager	<ul style="list-style-type: none"> <li>Diversification of assets incl. alternatives</li> <li>Review of Investment Strategy</li> <li>Bond yields already low</li> <li>Fund is not a forced seller of assets</li> <li>Regular funding valuations</li> <li>De-risking to dampen volatility</li> </ul>	7	5	35	<ul style="list-style-type: none"> <li>No comment</li> </ul>	31-Mar-2018
F	Operational	Scheme benefits incorrectly claimed following a pensioner death	8	3	24	Pensions Manager and Pensions Officers	<ul style="list-style-type: none"> <li>National Fraud initiative</li> <li>Pensioner ages analysed for oddities</li> <li>Investigation of returned payments</li> </ul>	4	3	12	<ul style="list-style-type: none"> <li>No comment</li> </ul>	31-Mar-2018

No.	Category	Risk	L	I	Risk Score	Assigned to	Mitigating Controls in Place	L	I	Current Risk	Comment	Review by
G	Operational	Fraud/theft of Fund assets by internal staff members	5	4	20	Pensions Manager and Pensions Officers	<ul style="list-style-type: none"> <li>Segregation/Rotation of duties</li> <li>Input and Authorisation separate</li> <li>Code of Conduct</li> <li>Documented Procedures</li> <li>Internal and external audit overview</li> </ul>	3	3	9	<ul style="list-style-type: none"> <li>No comment</li> </ul>	31-Mar-2018
H	Operational	Incomplete Member records (e.g. service, contributions, pay)	9	6	54	Pensions Manager	<ul style="list-style-type: none"> <li>Admin performance in Annual Report</li> <li>Employer training events</li> <li>Employer Communications</li> <li>Staff Training</li> </ul>	7	4	28	<ul style="list-style-type: none"> <li>No comment</li> </ul>	31-Mar-2018
I	Operational	Failure to complete Annual Accounts on time (June)	4	7	28	Pension Fund Accountant	<ul style="list-style-type: none"> <li>Agree Audit program timeously</li> <li>Attend CIPFA seminars</li> <li>Plan Timetable annually</li> <li>Use of qualified staff</li> <li>Appropriate Integra Training</li> </ul>	2	5	10	<ul style="list-style-type: none"> <li>Fund accountant appointed Feb 2016</li> </ul>	31-Mar-2018
J	Operational	Members' confidential data is lost or made public. Breach of Data Protection Act	7	7	49	Pensions Officers and Pensions Manager	<ul style="list-style-type: none"> <li>Data Protection Act training</li> <li>Induction Training</li> <li>Waste paper disposal facilities available</li> <li>Data encrypted when sent/received</li> <li>IT systems password secure</li> </ul>	5	7	35	<ul style="list-style-type: none"> <li>DPA Training to be reinforced</li> </ul>	31-Dec-2016
K	Operational	Staff error or inability to carry out duties in compliance with scheme rules	8	5	40	Pensions Manager and Pensions Officers	<ul style="list-style-type: none"> <li>Supervisor checks</li> <li>Critical activities under joint control</li> <li>Procedures manual</li> <li>Decision making underpinned by IT systems</li> <li>Internal and external audit</li> <li>Staff training on new Admin system ongoing</li> </ul>	6	3	18	<ul style="list-style-type: none"> <li>Maintain procedures manual</li> <li>Further round of staff training to be arranged</li> </ul>	31-Mar-2018
L	Operational	Failure of IT systems	7	7	49	Pensions Manager	<ul style="list-style-type: none"> <li>Data backed-up daily</li> <li>Back up Servers in place</li> <li>Contingency arrangements tested</li> <li>Liaison with Systems Account managers</li> </ul>	5	4	20	<ul style="list-style-type: none"> <li>Mobile and Flexible working will impact on platform</li> </ul>	31-Mar-2018
M	Operational	Recruitment and retention of key staff	8	7	56	Pensions Manager	<ul style="list-style-type: none"> <li>Staff training provided regularly</li> <li>Key man risk reduced through rotation of duties</li> <li>Trainee has been appointed</li> <li>Shared Service Platform with Lothian</li> </ul>	5	4	20	<ul style="list-style-type: none"> <li>No comment</li> </ul>	31-Dec-2016
N	Operational	Business continuity issues (accommodation, pandemics, etc)	7	6	42	Pensions Manager	<ul style="list-style-type: none"> <li>Business Continuity Plans in place</li> <li>Remote working available</li> </ul>	4	4	16	<ul style="list-style-type: none"> <li>Decision awaited about accommodation</li> <li>Mobile and flexible working arrangements to be introduced</li> </ul>	31-Mar-2017

No.	Category	Risk	L	I	Risk Score	Assigned to	Mitigating Controls in Place	L	I	Current Risk	Comment	Review by
O	Operational	Failure to meet statutory deadlines (e.g. benefit statements)	8	5	40	Pensions Manager	<ul style="list-style-type: none"> <li>Temporary staff recruited from re-deployment pool</li> <li>Engagement with employers regarding statutory obligations</li> </ul>	7	5	35	<ul style="list-style-type: none"> <li>Based on assessment of workload from new scheme and new admin system</li> </ul>	31-Dec-2016
P	Operational	Failure to migrate the pensioner payroll to new platform	7	8	56	Pensions Manager	<ul style="list-style-type: none"> <li>Experienced IT Provider</li> <li>Parallel running to be undertaken</li> <li>Dry run from transfer of Police/Fire data</li> <li>Part of Internal Audit Review Plan</li> </ul>	3	8	24	<ul style="list-style-type: none"> <li>No comment</li> </ul>	31-Dec-2016
Q	Governance	Committee and Board members have inadequate knowledge and understanding	8	5	40	Pensions Manager	<ul style="list-style-type: none"> <li>Training Events held on regular basis</li> <li>External audit presence at Committee</li> <li>LGPS regulations restrict actions</li> <li>Access to wide variety of advice</li> <li>Committee Minutes maintained and subject to approval</li> </ul>	6	4	24	<ul style="list-style-type: none"> <li>Undertake Training Needs Assessment</li> <li>Schedule new training events</li> </ul>	31-Dec-2016
R	Governance	Decisions influenced by possible conflicts of interest or not in the best interests of stakeholders	4	6	24	Pensions Manager	<ul style="list-style-type: none"> <li>Declarations of interest included as an opening agenda item for trustee meetings and minuted accordingly.</li> <li>Advisers attend most formal meetings</li> <li>Committee contains Union, Employer and Council reps</li> <li>Committee overseen by Board</li> </ul>	3	5	15	<ul style="list-style-type: none"> <li>Register of interests to be maintained</li> <li>Awaiting legal pronouncements on fiduciary duty</li> </ul>	31-Dec-2016
S	Investment	Manager under performs or performance monitoring is ineffective	8	7	56	Pensions Manager	<ul style="list-style-type: none"> <li>Secondment arrangement in place with Lothian Pension Fund</li> <li>Regular dialogue with managers</li> <li>Fund assets reviewed and reported on quarterly basis</li> <li>Poor performance highlighted at Committee and actions agreed</li> </ul>	6	4	24	<ul style="list-style-type: none"> <li>Continued training of staff and members</li> <li>Seek to de-risk if deficit reduces</li> </ul>	31-Mar-2018
T	Investment	Investment Managers may not have appropriate control framework in place	6	7	42	Pensions Manager	<ul style="list-style-type: none"> <li>Complete and authorised Investment Management Agreements in place</li> <li>Managers required to manage portfolios in accordance with the Statement of Investment Principles</li> <li>Regular dialogue with managers</li> <li>Manager resilience queried at Committee</li> <li>Compliance reports issued by Managers</li> </ul>	4	5	20	<ul style="list-style-type: none"> <li>Training sessions for staff and members</li> </ul>	31-Mar-2018
U	Investment	Pension Fund investments not accurately valued	5	5	25	Pension Fund Accountant	<ul style="list-style-type: none"> <li>Manager valuations are compared to the Custodian valuations and where material differences occur values are checked against independent source.</li> <li>Portfolio valuations are reported on a quarterly basis.</li> </ul>	3	4	12	<ul style="list-style-type: none"> <li>Explore available systems for improved recording of private equity</li> </ul>	31-Mar-2018

No.	Category	Risk	L	I	Risk Score	Assigned to	Mitigating Controls in Place	L	I	Current Risk	Comment	Review by
V	Investment	Custody arrangements may not be sufficient to safeguard Pension Fund's assets	4	9	36	Pension Fund Accountant	<ul style="list-style-type: none"> <li>• Agreements are in place with external custodian</li> <li>• Compliance reports obtained from Custodian</li> <li>• Monthly reconciliation of custodian/manager records</li> </ul>	2	9	18	<ul style="list-style-type: none"> <li>• Continue monitoring and reviewing existing arrangements</li> </ul>	31-Mar-2018
W	Investment	Investment Strategy is inappropriate	7	8	56	Pensions Manager	<ul style="list-style-type: none"> <li>• Regular dialogue with investment adviser</li> <li>• Access to specialist information through Lothian secondment arrangement</li> <li>• Periodic formal reviews of strategy</li> </ul>	5	7	35	<ul style="list-style-type: none"> <li>• No comment</li> </ul>	31-Mar-2018
X	Investment	Investment Risk (equity, interest rate, currency and credit risk) has not been adequately assessed.	7	7	49	Pensions Manager	<ul style="list-style-type: none"> <li>• Strategy is supported by investment adviser and through the Lothian secondment arrangement</li> <li>• Annual Accounts contain significant disclosure of nature and extent of investment risk</li> </ul>	5	6	30	<ul style="list-style-type: none"> <li>• No comment</li> </ul>	31-Mar-2018
Y	Investment	Asset Values affected by political uncertainty	8	7	56	Pensions Manager	<ul style="list-style-type: none"> <li>• Diversified Portfolio</li> <li>• Long Term Investment time horizons</li> <li>• Experienced Managers</li> </ul>	6	4	24	<ul style="list-style-type: none"> <li>• Current risk from possible BREXIT</li> </ul>	31-Dec-2018

The background of the slide features a large, light blue watermark of the University of Alberta crest. The crest is a shield divided into four quadrants. The top-left quadrant shows a castle tower, the top-right shows a stag's head, the bottom-left shows a sailing ship, and the bottom-right shows an eagle. Above the shield is a crown with four maple leaves. Below the shield is a banner with the motto 'ANNE FOR A'.

**AGENDA ITEM**

**8**

**INVESTMENT STRATEGY –  
ESG UPDATE**

**FALKIRK COUNCIL**

**Subject: INVESTMENT STRATEGY – ESG UPDATE**  
**Meeting: JOINT MEETING OF PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 11 MARCH 2016**  
**Author: DIRECTOR OF CORPORATE AND HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 This report updates the Pensions Committee and Board on environmental, social and governance (ESG) considerations arising from the review of investment strategy.
- 1.2 These matters have been the subject of discussion by the investment sub group.
- 1.3 Further legal and governmental announcements are pending and it is expected that the Committee and Board will wish to await the outcome of these developments before reaching a settled view.

**2. CURRENT POLICY**

- 2.1 The Fund's approach to ESG matters is set out in Section 9 of its Statement of Investment Principles (SIP). This acknowledges the Fund's obligations as a responsible investor and highlights its commitment to ensuring companies meet acceptable standards of practice with a particular focus on human rights, environmental issues and employment standards.
- 2.2 Engagement and influence takes place through the Fund:
  - having regular discussions with its Asset Managers on their own specific ESG monitoring;
  - exercising voting rights through proxy voting agents; and
  - being a member of the Local Authority Pension Funds Forum.
- 2.3 Fund policy, in general, is not to interfere in the investment decisions of Managers and to allow them to base their decisions on the risk / return characteristics of each investment opportunity.
- 2.4 Corporate governance matters of significance are reported quarterly to the Pensions Committee and Board. Managers are also monitored to ensure that they have ESG considerations embedded into their investment processes and into their evaluation of risk and return.

### 3. WIDER CONSIDERATIONS

3.1 The sub group considered the following aspects of the Fund's ESG obligations:

#### **Regulatory**

3.2 Funds must maintain a statement of the investment principles ("SIP") which specifies how social, environmental or ethical matters are taken into account in investment decision making.

3.3 Funds must take proper advice to ensure that their investment policy delivers a wide variety of suitable investments.

#### **Fiduciary Duty**

3.4 Pensions Committees owe a fiduciary duty to Fund stakeholders (i.e. beneficiaries, employers and tax payers) to act in their best interests putting their own personal interests and views aside.

3.5 Historically, the prevailing view has been that the interests of stakeholders are best served by Trustees pursuing the maximum financial returns for an acceptable level of risk - this being the investment principle most likely to find favour amongst widest range of stakeholders.

3.6 As bad corporate practice can impact on shareholder value and be a Fund risk, it may be a breach of fiduciary duty if Trustees do not take account of ESG issues in some way.

#### **Legal Consensus**

3.7 A number of legal opinions have been provided regarding the extent to which Trustees (and Pensions Committees) can base investment decisions on factors other than financial ones

3.8 The consensus of opinion is broadly as follows:

- Funds' primary focus should be on generating financial returns
- Investment decisions should be aimed at achieving a wide variety of suitable investments
- Excluding certain investments is acceptable so long as:
  - financial returns are not harmed
  - the Fund is continuing to invest in a wide variety of investments
  - proper advice as to the financial consequences of exclusion has been taken
  - the non-financial aims giving rise to the divestment or exclusion are shared by the majority of stakeholders

#### **Divestment**

3.9 The Fund periodically receives representations from lobbyists to refrain from investing in certain assets on ethical grounds (e.g. fossil fuel, tobacco and arms).

3.10 The main arguments against divestment are:

- Fund's primary focus should be to maximise returns
- Risk of legal challenge from members, employers and taxpayer groups
- Investment risk is best controlled by having the broadest diversification
- Excluding one sector increases the pressure to exclude others, resulting in a shrinking investable universe

- Divestment removes the chance to influence corporate practice in that sector
- Other less socially responsible investors may simply replace the divestment, quite possibly at an attractive share price

3.11 Set against 3.10, an investment policy that gives Managers a “free hand” carries the risk of reputational damage from being invested in contentious shares. Some investments may also be at odds with public policy initiatives (e.g. health).

#### **4. CURRENT DEVELOPMENTS**

4.1 Several important pronouncements are expected in the coming months on the extent to which Funds can take non-financial factors into account when formulating investment policy. These are:

- a legal opinion commissioned by the Scottish Scheme Advisory Board
- the UK Government response to a consultation on Occupational Pension Schemes Investment Regulations
- pending amendments to scheme rules in England and Wales

4.2 In view of the fact that further information on ESG responsibilities will be available later this year, it is proposed to revisit this topic at that time, and hold a training session dedicated to the subject. This need not delay implementation of other strands of the investment strategy since, if it transpired that Funds were to be given greater scope to divest or refrain from investing in certain sectors (and the Committee wished to pursue that course), it would be possible to amend investment mandates at that time.

#### **5. CONCLUSION**

5.1 Successive legal opinions suggest that a Fund’s primary goal should be to deliver the financial returns necessary to meet the ongoing cost of pensions and lump sum benefits.

5.2 There may be scope for LGPS Funds to refrain from investing in certain sectors or from investing in certain companies. However, this is subject to constraints such as ensuring that financial returns are not damaged; that the Fund continues to have a broad range of suitable investments; and that the rationale behind the non-investment is a view commonly held by the majority of Fund stakeholders.

5.3 A training event to take account of the latest developments in this area will be held later in the year.

#### **6. RECOMMENDATIONS**

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

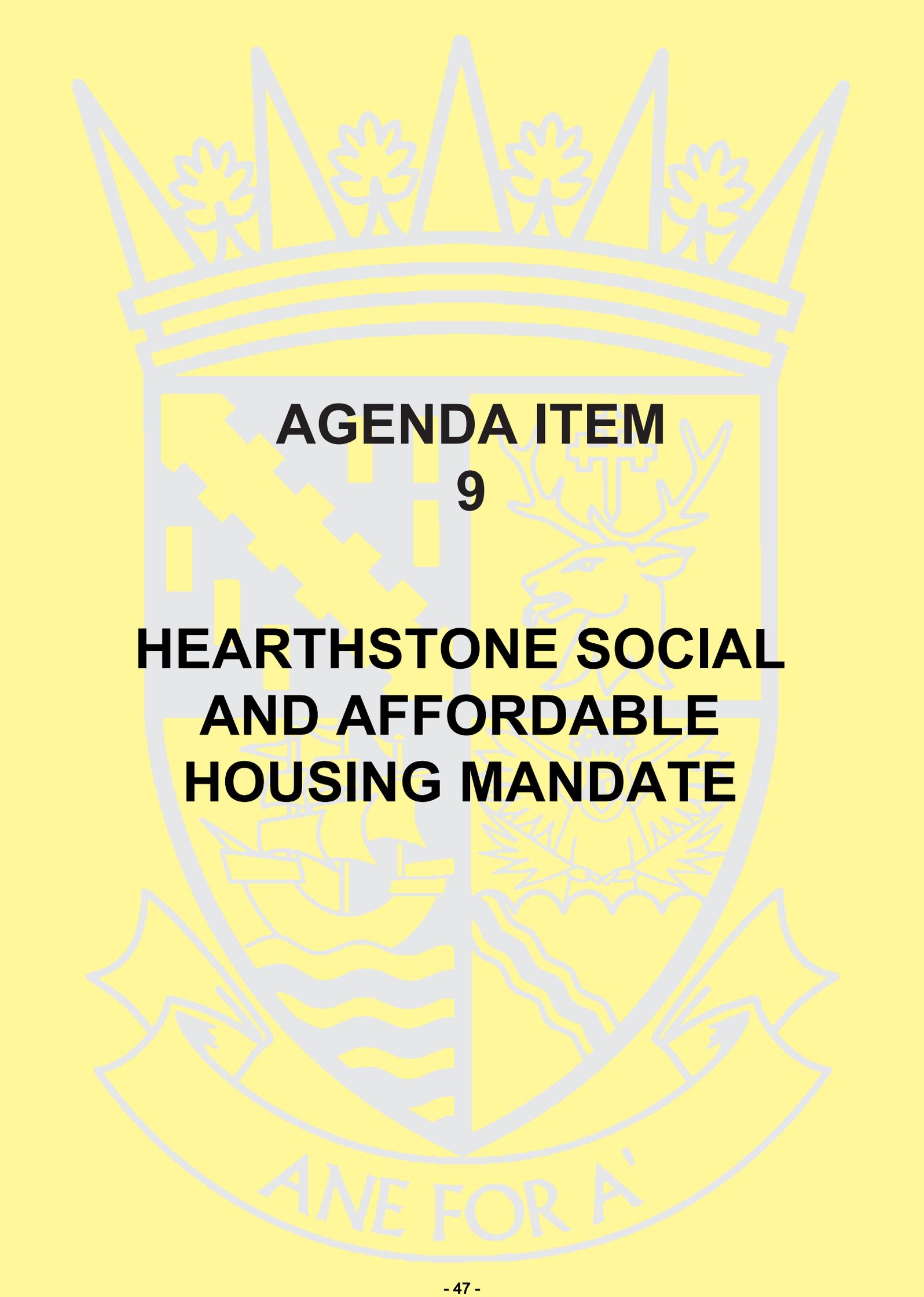
**6.2 The Pensions Committee is asked to agree that a dedicated training event be held in due course addressing the Fund's approach to Environmental, Social and Ethical matters in relation to investment decision making.**

pp **Director of Corporate & Housing Services**

**Date: 29 February 2016**

**Contact Officer: Alastair McGirr**





**AGENDA ITEM**

**9**

**HEARTHSTONE SOCIAL  
AND AFFORDABLE  
HOUSING MANDATE**

ANE FOR A'

**FALKIRK COUNCIL**

**Subject: HEARTHSTONE SOCIAL AND AFFORDABLE HOUSING MANDATE**  
**Meeting: JOINT MEETING OF PENSION COMMITTEE AND PENSION BOARD**  
**Date: 11 MARCH 2016**  
**Author: DIRECTOR OF CORPORATE AND HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 This report updates the Pensions Committee and Pension Board with matters relating to the Fund's investment in Social and Affordable Housing with Hearthstone Investments.

**2. BACKGROUND**

- 2.1 In 2014, the Pensions Committee agreed to make a £30m investment in Hearthstone's Housing Fund for Scotland in order to fund new Social and Affordable Housing. The investment was made on the basis of £15m being allocated to social housing and £15m to affordable housing.
- 2.2 The Fund's return objective is RPI + 2%. In order to deliver the new property units, Hearthstone has been working in partnership with Castle Rock Edinvar, the Edinburgh based Housing Association who are part of the Places for People Group.
- 2.3 The £15m earmarked for social housing has, to date, been invested in successive short term debt instruments with the Places for People Group. In return, the Fund has received the commitment from the Group that they would invest £15m in Social Housing in the Clackmannanshire, Falkirk and Stirling areas.
- 2.4 The Social Housing Programme is now well advanced and involves the construction of 195 units across the pension fund area as follows:

<b>Area</b>	<b>Site</b>	<b>Number of Units</b>
Clackmannanshire	Sauchie	39
Falkirk	Bellsdyke	62
	Overton	34
Stirling	Durieshill	60
TOTAL		195

- 2.5 As a result of the Falkirk Fund's investment, financial support was also made available from the Scottish Government allowing the final Social Housing Programme to be worth £25m. All units are expected to be completed in 2017.

2.6	Turning to the affordable housing part of the investment, the following purchases have been made by Hearthstone:		
	17 Units in Bo'ness	-	£1.8m
	16 Units in Rutherglen	-	£1.6m
	18 Units in Aberdeen	-	<u>£4.5m</u>
			<u>£7.9m</u>

The balance of the initial allocation (£7.1m) is still to be deployed.

### 3. LATEST DEVELOPMENTS

3.1 Changes to government policy on social and affordable housing provision have led the Places for People Group to restructure their Medium Term Bond Issuance Programme. As a result, the debt instruments originally used to support the Social Housing Programme have been repaid. This does not however impact on the £25m Social Housing Programme which continues to move forward with the full commitment of the Places for People Group.

3.2 The Group have now re-launched their latest bond issuance programme, and the Fund can therefore resume its original purpose and secure a 10 year bond, which is expected to yield around 3% p.a. (i.e. below the target return for the Fund). Hearthstone have intimated that as the Social Housing Programme has been secured, there is an alternative for the Falkirk Fund – still involving the Places for People Group - which may deliver superior returns and which the Committee may wish to consider.

3.3 The proposal is for Hearthstone to use the £15m to acquire further affordable housing assets and then lease them back to the Places for People Group. Hearthstone estimates that this approach would yield around 6% (net of fees) based on the rental stream and the capital growth of the properties over the term of the lease. The properties acquired would be:

- New Build (unless exceptional market conditions dictated otherwise)
- Located in Scotland
- Leased for between 7 and 9 years (the remaining life of the Housing Fund for Scotland)
- Leased to inflate at CPI +0.5%
- Capable of being sold or re-let on expiry of the lease
- Sourced by Hearthstone and managed by the Places for People Group.

3.4 It is recognised that in order to deliver the £15m tranche of social housing Castle Rock Edinvar needed there to be financial support from the Scottish Government. This was ultimately provided through the Scottish Government's Innovative Financing Unit, taking account of future social housing allocations to Clackmannanshire, Falkirk and Stirling Councils. It is unlikely that this financial support would be available again in the near future should the Committee wish to use the £15m to provide a further round of social housing provision. Anecdotal evidence also indicates that other asset managers who are seeking to invest in social housing are experiencing difficulty in deploying the capital into the market.

### 4. RISK PROFILE

4.1 The risk profile of physical property is clearly different to that of a bond from a regulated body such as the Places for People Group. It is the Hearthstone view however that the additional yield that can be achieved by entering into a leasehold arrangement is adequate compensation for the additional risk to capital, particularly given the fact that the investment will be secured against the underlying property assets.

- 4.2 The main risk is one of timing should a significant market downturn occur at the same time as the expiry of the lease to Places for People's group (and the expected exit date of the fund). This could be mitigated by extending the lifetime of the investment, phasing the subsequent sale of assets, or by re-letting the assets. Further mitigation of the risk could come the fact that the housing assets would be ungeared and geographically diversified across Scotland.

## **5. ADVISOR VIEW**

- 5.1 Hymans Robertson, the Fund's investment adviser, has been consulted regarding the options and are supportive of the purchase and leaseback proposal.

## **6. CONCLUSION**

- 6.1 The Places for People Group have completed the re-structuring of their bond issuance programme. The Falkirk Fund can choose to secure a 10 year bond from the Group as originally envisaged or it could update the mandate to allow Hearthstone to secure a further £15m in affordable assets on a purchase and lease back arrangement with Places for People.
- 6.2 Should the Committee agree to the purchase and lease option, the number of houses created by the fund's investment will increase, as previously the fund was limited to c. 200 homes from the Social Housing Programme plus the units generated from the £15m on affordable housing provision. It would now be generating the 200 homes from the Social Housing Programme, plus £30m of affordable housing.
- 6.3 The proposal from Hearthstone seeks to recycle the initial capital investment that has facilitated the development of Social Housing. The proposal offers the potential to deliver a superior return for the Fund with risk being at a tolerable level, particularly in light of the overall scale of the investment relative to the Fund as a whole. Importantly, the proposal would not affect the ongoing Social Housing Programme and affordable housing component as agreed in the original mandate.

## **7. RECOMMENDATIONS**

- 7.1 **The Pensions Committee and Pension Board are asked to note the developments surrounding the Social and Affordable Housing mandate.**
- 7.2 **The Pensions Committee is asked to determine whether £15m of the investment should continue to be invested in the debt programme of the Places for People Group or used to acquire new affordable housing units with a view to these being leased back to the Group.**

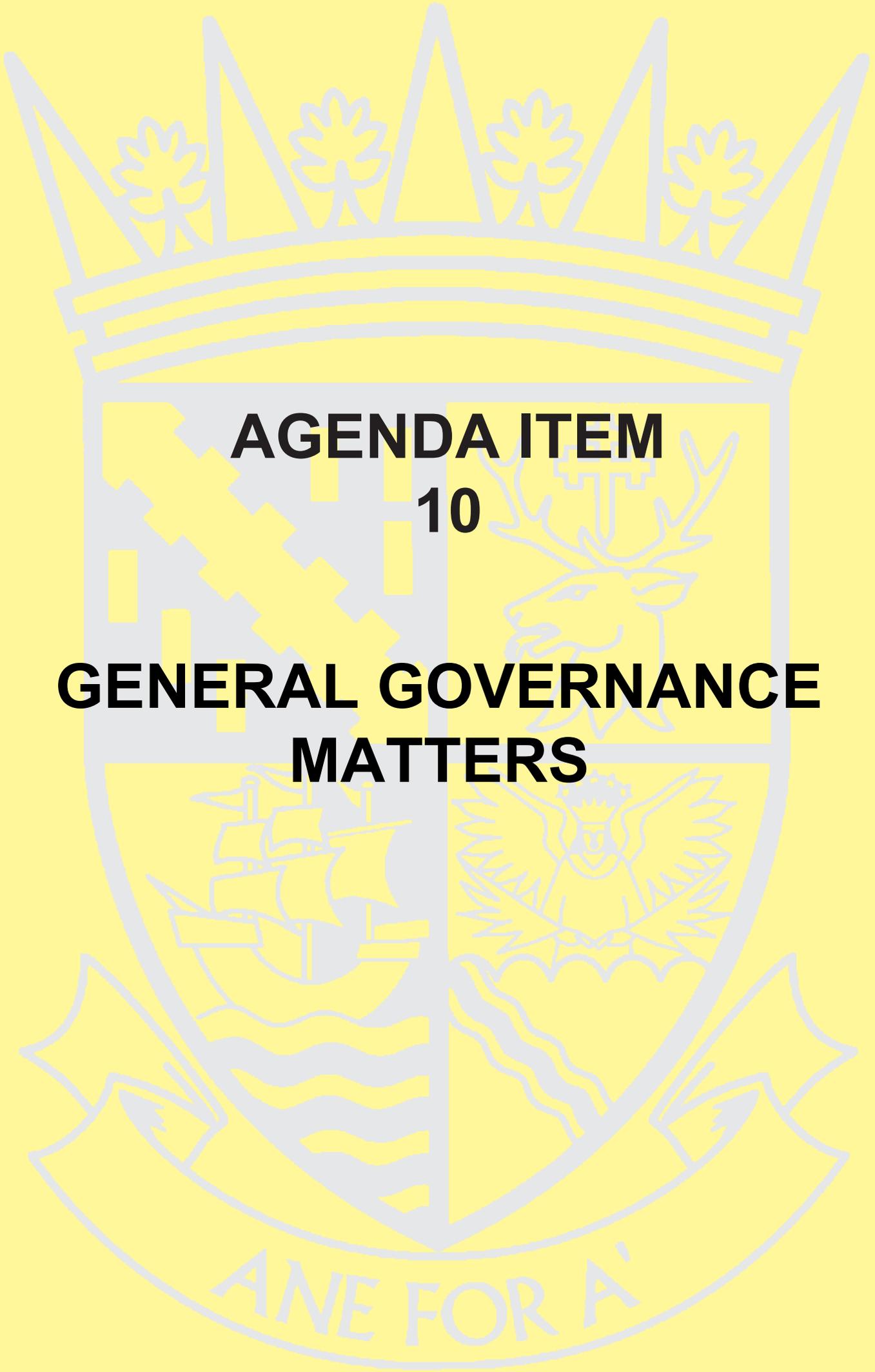
**Director of Corporate and Housing Services**

**Date: 1 March 2016**

**Contact Officer: Alastair McGirr**

### **LIST OF BACKGROUND PAPERS**

NIL



**AGENDA ITEM**

**10**

**GENERAL GOVERNANCE  
MATTERS**

ANE FOR A'

**FALKIRK COUNCIL**

**Subject: GENERAL GOVERNANCE MATTERS**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 11 MARCH 2016**  
**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 Due to the September, 2015 inflation rate being negative (-0.1%), there will be no increase in the rate of pensions paid to LGPS pensioners this year.

2.2 The UK Government has now indicated that it intends to apply the negative revaluation of -0.1% to the career average benefits earned by LGPS members during 2015/16. This power to apply a negative factor is permitted under the terms of the Public Service Pensions Act 2013.

**3. PENSION SCHEME TAX ISSUES**

3.1 During last year, the UK Government issued a Green Paper on reforming tax relief with the aim of ‘strengthening the incentive to save’. One of the options proposed in the Green Paper was for the pensions system to move away from the current “EET” approach (i.e. pension contributions *exempt* from tax, investment growth *exempt*, and pensions in payment *taxed*) and move to a “TEE” system (contributions made from *taxed* income, investment growth *exempt*, pension payments *exempt*).

3.2 If the above proposal is not taken forward, a further option being considered is to restrict tax relief on contributions to a flat rate of 20%.

3.3 These matters should be clarified during the Chancellor’s Budget on 16<sup>th</sup> March.

3.4 The following matters have already been determined:

- Lifetime Allowance reducing from **£1.25m** in 2015/16 to **£1m** in 2016/17
- Annual Allowance remains at **£40k** for 2016/17 except for earners with “adjusted income” of over **£150k** in which case the allowance is **£10k**.

3.5 The latest round of reductions to annual and lifetime allowances means that an ever increasing number of members will be caught by the provisions. This is a complex and technical area which continues to require an increasing level of resource from the Pensions Section.

#### **4. SCHEME CHANGES**

4.1 The Scottish Public Pensions Agency has made the following amendments to the Scheme rules as follows:

- surviving spouse of a same sex marriage and the surviving partner of a same sex partnership are now entitled to the same benefits as couples of the opposite sex
- where a scheme employer ceases to have any active members, the administering authorities may delay seeking a cessation payment for a period of up to 3 years, provided they are satisfied the employer will have active members in that period
- to recognise that if the cost to employers of funding the scheme exceeds the cost cap by more than a permitted margin, then Scottish Ministers will agree with Funds the steps to be taken to achieve the target cost. This may involve adjusting the rate at which member benefits accrue. The cost cap has been set at 15.5% of members' earnings. The permitted margin is 2% above or below the cost cap. The next assessment of scheme cost will be 31<sup>st</sup> March, 2017.
- the proportion that local authority pension funds can invest in partnerships has been increased from a maximum of 15% of the fund to a maximum of 30%. The Falkirk Fund's investments with SL Capital, Wilshire and Grosvenor all use a partnership structure and currently amount to around 7.5% of the Fund.

#### **5. ANNUAL BENEFIT STATEMENTS**

5.1 Historically, Administering Authorities have had 12 months after the 31<sup>st</sup> March year end in which to issue annual statements. Under new scheme rules, this timeframe has been shortened to 5 months after the year end (i.e. by 31<sup>st</sup> August). This places a significant responsibility on fund employers to submit year end data returns promptly after the year end and to deal with follow on queries swiftly.

5.2 Failure to meet the deadline would require the Pensions Committee and Board to consider reporting the breach to the Pensions Regulator. The Regulator's Public Service Code of Practice provides guidance on judging whether a breach needs to be reported.

5.3 It is noted that in the first year of the Career Average Scheme being introduced in England and Wales, a number of Funds self-reported to the Regulator. The Regulator's response was that where the breach was attributable to data and IT system issues faced by Funds and Fund employers, they would expect Funds to issue statements by the 30 November. Where Funds were unable to meet this timeframe, Funds would need to submit a plan of action for remedying the breach. Plans would be considered on a case by case basis and the Regulator would consider what action to take.

## **6. NEW STATE PENSION SCHEME**

- 6.1 The new State Pension Scheme is being introduced from 6 April, 2016 for persons reaching State Pensions Age (SPA) on or after that date. It is a single tier benefit which replaces the existing basic and additional state pensions. The amount currently set for the new State Pension is £155.65 pw, however not everyone will receive this amount (e.g. you need at least 35 years of National Insurance credits).
- 6.2 As part of the new arrangements, contracting-out is being abolished.
- 6.3 Contracting Out allows employees and employers who participate in a contracted out pension scheme, such as the Local Government Pension Scheme, to pay a reduced rate of national insurance. This concession will disappear on 6 April and employees will incur an increase of 1.4% on their earnings between £5,824 and £40,040 (roughly £5 pw for someone earning £25k and £9 pw for someone earning £40k)
- 6.4 For those who qualify for the new State Pension and who have been in a contracted out scheme, the amount of new State Pension allocated on 6 April will be at least as much as the individual would have received under the former arrangements.
- 6.5 Documentation explaining the new arrangements has been uploaded to the News area of the Pension Fund website ([www.falkirkpensionfund.org](http://www.falkirkpensionfund.org)).
- 6.6 From the Fund's perspective, the abolition of contracting out means that the Fund will have to meet the full cost of indexing scheme pensions. Up till now, part of the pension known as the Guaranteed Minimum Pension has been indexed by the State.
- 6.7 With the new arrangements coming on stream, HMRC are conducting a reconciliation exercise to compare its contracting out data with that of pension scheme providers. This work is considered necessary to satisfy the Pension Regulator's data quality standards; to ensure as far as possible that pensioners are receiving the correct level of pension; and to check that that no liabilities have been incorrectly attributed to the Fund. Steps are in hand to recruit a temporary Pensions Support Assistant to take forward the Fund's own reconciliation process. The scale of the exercise, however, in looking at records going back to 1978 means that it will be necessary to engage external providers to assist with data management process.

## **7. RECOVERY OF PUBLIC SECTOR EXIT PAYMENTS**

- 7.1 The UK Government has powers under the Small Business, Enterprise and Employment Act 2015, to recover exit payments where a high earner takes up a post anywhere within the public sector within 12 months of having exited their employment.
- 7.2 The "payments threshold" at which the provisions will apply has been set at £80k. The significance for LGPS Pension Funds is that this includes any strain payment which an employer may have paid to secure the early payment of scheme benefits.

- 7.3 The provisions are expected to apply in England from April, 2016. It will, however, be a matter for devolved administrations in Scotland, Wales and Northern Ireland to decide the extent to which they wish to make similar provision.
- 7.4 The UK Government is also consulting on the actual costs associated with early termination of employment across the public sector. Options being considered are to restrict the level of termination payment through capping the number of weeks' pay and level of salary taken into account and capping or removing the ability for employers to fund early release of pension benefits on redundancy, or increasing the minimum age at which an employee can receive such payments from an employer (5 years from an individual's normal pension age has been suggested).

## **8. NATIONAL LGPS DATABASE AND TELL US ONCE**

- 8.1 The 2015 version of the Scheme requires Funds to ascertain whether:
- a) a member has had a break in continuous public sector service of more than 5 years;
  - b) a member has an entitlement to more than one death grant; and
  - c) a member has previously been retired on ill health grounds
- 8.2 To assist all Funds in meeting these new requirements, a national LGPS database is being established. The database is being hosted by the South Yorkshire Pensions Authority with whom data sharing agreements are being completed.
- 8.3 In due course, it is intended that the database will be extended to enable Funds to participate in the Tell Us Once initiative which allows citizens to report a family member's death to a number of government entities in one go.
- 8.4 As well as simplifying the process of reporting deaths, participation in the facility should reduce the chance of deaths not being notified to Funds and thereby reduce the risk of overpayments. All LGPS pension funds in England, Wales and Scotland are expected to participate in the Tell Us Once Service

## **9. CORPORATE GOVERNANCE MATTERS**

- 9.1 To help discharge its obligations as a responsible investor, the Fund is a member the Local Authority Pension Funds Forum (LAPFF). The LAPFF represents the interests of 68 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.
- 9.2 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.
- 9.3 The recent quarter has seen LAPFF hold face to face meetings or have written exchanges with:

**BP** – discussing the steps being taken to mitigate its climate change impacts, including: calling on governments to implement a carbon price; developing BP’s renewable business in biofuel and wind; improving energy efficiency; and contributing to research and development.

**Shell** – discussing current oil price; the importance of communicating climate change science simply and clearly to investors; improving disclosure following the Aiming for A campaign; the proposed BG acquisition; and, in anticipation of the declining demand for coal, Shell’s increasing focus on integrated gas.

**SSE** – discussing succession planning process; living wage and home energy efficiency.

**BHP Billiton** – querying management response to the recent burst dam at a mine in Brazil resulting in a number of fatalities.

**Sports Direct** – expressing concern over the use of zero hours contracts.

- 9.4 Falkirk Council was one of 18 LGPS Funds which with other investors co-filed a strategic resilience shareholder resolution at the AGM of Anglo American calling on the company to be more transparent over climate change risks to their business.

## 10. OBJECTIVE CONNECT

- 10.1 Committee and Board members are reminded that it is a statutory requirement for the performance of external managers to be reviewed at least every 3 months. For that reason, it is a requirement that manager booklets are made available to Committee and Board members.
- 10.2 It is recognised that the provision of the quarterly booklets in hard copy format can be cumbersome for Committee and Board members and may be wasteful in terms of the paper expended in producing the reports. There is now an option for the booklets to be made available to members electronically using a product called Objective Connect.
- 10.3 Using Objective Connect, it would be possible to upload the manager booklets each quarter to a secure shared folder on the web from where they could be accessed by registered users (i.e. only registered users would have access to the files). In terms of data security, Objective Connect is endorsed by the Council’s ICT section; meets the International Standard of ISO 27001:2013 for Information Security Management Objective Connect; and has appropriate accreditation under Cabinet Office’s G-Cloud programme.
- 10.4 If this proposal is acceptable to Committee and Board members, the pensions manager will issue an email inviting members to register for Objective Connect. Members who prefer to continue receiving hard copies of reports will be able to do so.

**11. RECOMMENDATION**

**11.1 The Pensions Committee and Pensions Board are invited to note the content of this report.**

pp **Director of Corporate & Housing Services**

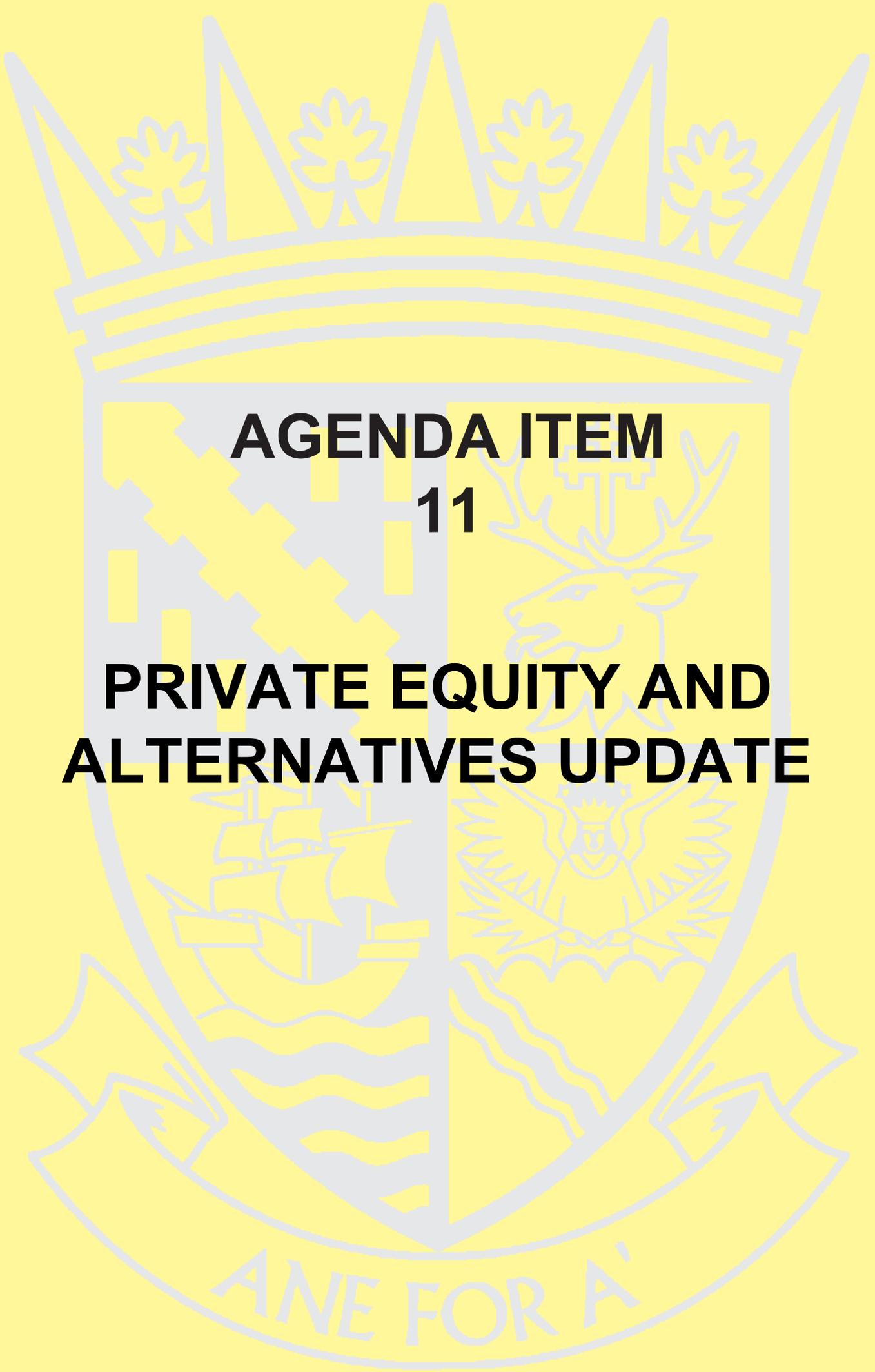
**Date: 25 February 2016**

**Contact Officer: Alastair McGirr**

**LIST OF BACKGROUND PAPERS**

NIL





**AGENDA ITEM**

**11**

**PRIVATE EQUITY AND  
ALTERNATIVES UPDATE**

FALKIRK COUNCIL

**Subject: PRIVATE EQUITY AND ALTERNATIVES UPDATE**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**  
**Date: 11 MARCH 2016**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

1.1 This report updates the Pensions Committee and Board on the progress and key events arising from each Manager's investment programme for the three months to 31 December 2015.

1.2 The Fund's private equity and alternatives programme is managed as follows:

SL Capital (Standard Life)	- European Private Equity
Wilshire Associates	- Global Private Equity
Grosvenor Capital	- Global Infrastructure
M&G	- Credit Markets
Hearthstone	- Social and Affordable Housing
In House/Lothian	- UK Infrastructure

1.3 The Fund's strategic allocation to private equity and alternatives (excluding the allocation to the Baillie Gifford Diversified Growth Fund) is set at 10% of total fund assets. This is split 5% to private equity and 5% to infrastructure.

1.4 The attached schedules give details of the current valuations and commitment levels in both the original currencies and summarised in Sterling (Appendices A and B). Appendix C shows the level of calls and distributions over the past 2 years.

**2. SL CAPITAL PARTNERS**

2.1 SL Capital is a subsidiary of Standard Life Investments, who in turn own 60% of the business. The remaining 40% is owned by 8 partners.

2.2 The Fund's overall commitment to SL Capital is €102m spread across four European Investment Funds – ESP 2004, ESP 2006, ESP 2008 and ESF 1 – all being fund of fund structures. The partnerships have been established for 14 years from the final close of each Fund.

2.3 During the quarter (Q4 2015), **€6.2m was returned** from Funds ESP 2004, 2006 and 2008 and **€2.9m was called** from ESP 2008 and ESF I, reducing the overall unfunded commitment to €19m.

- 2.4 Within the portfolio, primary funds again tended to outperform co-investments. Highlights were the sale of Solina (food processing) and the IPO for Attendo (Healthcare). However, the slump in oil and gas prices had an impact on the valuations of Expro and the Harding Group.

### 3. WILSHIRE ASSOCIATES

- 3.1 The Fund's commitments to Wilshire Associates are as follows:

European Funds	-	<u>€10.9m</u>
Dollar Funds		<u>\$72.0m</u>

- 3.2 Roughly 9% of the Euro funds and 23% of the dollar funds remain to be drawn down.
- 3.3 During the quarter, Wilshire distributed **€1m** (mainly from Euro Funds VII and VIII) and **\$1.7m** from US Funds VI, VII and VIII. Capital calls amounted to **\$0.8m** in respect of the Opportunities Fund and Fund IX. Total value to paid in capital increased marginally to 1.44 from 1.42 last quarter.

### 4. GROSVENOR CAPITAL

- 4.1 The Fund's global infrastructure mandate comprises a commitment of \$80m to the Customised Infrastructure Strategies (CIS) Fund managed by the Grosvenor Capital Customised Fund Investment Group (CFIG).
- 4.2 During the quarter, the Fund distributed **\$4.4m** and called **\$1.4m**. Total value to paid in capital was unchanged from the previous quarter. The mandate is almost fully invested with only 9% still to be drawn down.
- 4.3 The most significant valuation changes in the quarter related to the Macquarie Korea Growth Private Equity Fund and Macquarie European Infrastructure Fund 1. The latter's portfolio includes AGS Airports who own Glasgow, Aberdeen and Southampton Airports.
- 4.4 At the December meeting, the Pensions Committee agreed to make an \$80m commitment to Grosvenor's second global infrastructure fund ("CIS II"). The decision was taken following discussions at the investment sub group and on the advice of the investment adviser, Hymans Robertson. The partnership agreement relating to CIS II is currently being reviewed by the mutual legal teams.

### 5. M&G UK COMPANIES FINANCING FUNDS

- 5.1 The M&G UK Companies Financing Funds provide debt finance to companies facing refinancing obstacles. The Funds aim to deliver LIBOR plus 3%-6% with a minimal level of risk.
- 5.2 Falkirk's commitment to the M&G Funds is £11.8m to Fund I and £10m to Fund II. Fund I has been fully invested and Fund II is in the process of being drawn down with unfunded commitments of £6m. In the fourth quarter, the Funds distributed **£1.4m**, mainly from Fund 1. There were no calls within this quarter.

- 5.3 For Fund I, the portfolio consists of 7 loans with an average repayment period of 4 years and average credit ratings of BB+. The loans are spread across the building, utilities, financial and transport sectors. Loans still to be repaid include companies such as Barrett, Taylor Wimpey, Wincanton and Provident Financial. The net annualised return is 4.5%.
- 5.4 For Fund II, the portfolio consists of 8 loans with an average repayment period of 5 years. This includes loans to Caffè Nero, Holidaybreak Limited and Workplace Group plc. The net annualised return is 3.5%.
- 5.5 All loans continue to be paid in accordance with their covenants.

## **6. SOCIAL AND AFFORDABLE HOUSING**

- 6.1 The Committee has made a £30m commitment to Hearthstone Investments to fund Social and Affordable Housing via their Housing Fund for Scotland. The Fund objective is to deliver returns of RPI + 2%.
- 6.2 The Fund's initial investment of £15m has facilitated a building programme of 195 units across the Forth Valley area. This is being supported by local authorities and the Scottish Government. All units are scheduled for completion by 2017.
- 6.3 A separate report has been tabled which considers options for the Hearthstone mandate.

## **7. IN HOUSE – UK INFRASTRUCTURE**

- 7.1 Following the decision of the Pensions Committee at the December meeting, the Fund now has a total commitment to UK infrastructure of £60m through the collaboration with the Lothian Fund.
- 7.2 To date, four commitments have been made to the following projects:
- FIM Harburnhead - £3m towards the construction of a wind farm in the Pentland Hills
  - Ancala Renewables - £7.6m towards a series of small scale hydroelectric plants in the Highlands
  - Dalmore Capital - £7.5m towards construction of the Thames Tideway Tunnel (sewer)
  - Ancala Renewables - £4.6m towards purchase of a portfolio of solar assets across UK
- 7.3 During the recent quarter, two calls were made - **£0.3m** in respect of Ancala Renewables and **£0.5m** to Dalmore Capital. Also within the quarter, an additional commitment of £3.6m was made to the hydro project with Ancala, increasing the total commitment to £7.6m.

## **8. CONCLUSION**

- 8.1 The alternatives portfolio returned 2.93% over Q4 and comfortably outperformed the cash benchmark by around 2.5%.
- 8.2 The alternatives programme continues to evolve across a broad range of diversified asset classes, including private equity, infrastructure and social/affordable housing.

**9. RECOMMENDATION**

- 9.1 The Pensions Committee and Pension Board are asked to note the progress of the Fund's Alternatives investments as at 31 December 2015 and invited to comment as appropriate.**

pp **Director of Corporate & Housing Services**

**Date: 1 March 2016**

**Contact Officer: Alastair McGirr**

**LIST OF BACKGROUND PAPERS**

NIL

Appendix 1

Falkirk Council Pension Fund  
Alternative Markets Update - 31/12/15

Alternative Assets Summary - Original Currency

Manager	Fund	Commitment 000's	Unfunded 000's	(a) Cost 000's	(b) Return of Cost 000's	(c) Distribtn Gains 000's	(d) Market Value 000's	(b + c + d) Total Value 000's	Total Value to Paid in Cap.	Inception Rate of Return	Percentage to be drawn down
<b>Private Equity</b>											
SL Capital Partners	European Strategic Partners 2004	30,000	3,169	26,831	14,506	11,216	10,110	35,832	1.34	6.6%	
SL Capital Partners	European Strategic Partners 2006	30,000	3,078	26,922	12,248	7,727	15,488	35,463	1.32	4.1%	
SL Capital Partners	European Strategic Partners 2008	27,000	5,771	21,229	4,234	3,320	18,483	26,037	1.23	1.5%	
SL Capital Partners	European Smaller Funds I	15,000	7,254	7,746	561	-	6,834	7,395	0.95	-32.1%	
<b>SL Capital Partners Total</b>		<b>€ 102,000</b>	<b>€ 19,272</b>	<b>€ 82,728</b>	<b>€ 31,549</b>	<b>€ 22,263</b>	<b>€ 50,915</b>	<b>€ 104,727</b>			18.9%
Wilshire Associates	Fund VI - Europe	3,600	223	3,377	2,106	1,414	1,318	4,838	1.43	7.8%	
Wilshire Associates	Fund VII - Europe	3,600	170	3,430	1,580	975	1,996	4,551	1.33	2.1%	
Wilshire Associates	Fund VIII - Europe	3,700	610	3,090	1,078	1,105	2,487	4,670	1.51	31.1%	
<b>Wilshire Associates Europe Total</b>		<b>€ 10,900</b>	<b>€ 1,003</b>	<b>€ 9,897</b>	<b>€ 4,764</b>	<b>€ 3,494</b>	<b>€ 5,801</b>	<b>€ 14,059</b>			9.2%
Wilshire Associates	Fund VI - US	14,000	751	13,249	6,360	6,687	6,506	19,553	1.48	7.5%	
Wilshire Associates	Fund VII - US	11,500	523	10,977	4,036	4,697	7,450	16,183	1.47	8.3%	
Wilshire Associates	Fund VIII - US	12,700	603	12,097	4,317	3,569	10,073	17,959	1.48	12.2%	
Wilshire Associates	Fund VII - Asia	1,800	140	1,660	990	715	666	2,371	1.43	8.8%	
Wilshire Associates	Fund VIII - Asia	2,000	1,102	898	419	175	618	1,212	1.35	-8.4%	
Wilshire Associates	Opportunities Fund II-B	15,000	1,780	13,220	7,450	2,728	8,898	19,076	1.44	13.0%	
Wilshire Associates	Fund IX	15,000	11,758	3,242	-	-	3,519	3,519			
<b>Wilshire Associates US and Asia Total</b>		<b>\$ 72,000</b>	<b>\$ 16,657</b>	<b>\$ 55,343</b>	<b>\$ 23,572</b>	<b>\$ 18,571</b>	<b>\$ 37,730</b>	<b>\$ 79,873</b>			23.1%
<b>Infrastructure</b>											
Grosvenor Capital	Customised Infrastructure Strategies	80,000	7,912	72,088	15,071	14,427	62,636	92,134	1.28	9.5%	
<b>Grosvenor Capital Total</b>		<b>\$ 80,000</b>	<b>\$ 7,912</b>	<b>\$ 72,088</b>	<b>\$ 15,071</b>	<b>\$ 14,427</b>	<b>\$ 62,636</b>	<b>\$ 92,134</b>			9.9%
<b>Credit Markets</b>											
Prudential/M&G	UK Companies Financing Fund	11,835	-	11,835	6,184	-	7,669	13,853	1.17	4.5%	
Prudential/M&G	UK Companies Financing Fund II	10,000	6,034	3,966	372	89	3,780	4,241	1.07	3.5%	
<b>Credit Market Total</b>		<b>£ 21,835</b>	<b>£ 6,034</b>	<b>£ 15,801</b>	<b>£ 6,556</b>	<b>£ 89</b>	<b>£ 11,449</b>	<b>£ 18,094</b>			27.6%
<b>Social / Affordable Housing</b>											
Hearthstone plc	Housing Fund for Scotland	30,000	6,850	23,150	-	-	23,150	23,150	1.00		
<b>Social/Affordable Housing Total</b>		<b>£ 30,000</b>	<b>£ 6,850</b>	<b>£ 23,150</b>	<b>£ -</b>	<b>£ -</b>	<b>£ 23,150</b>	<b>£ 23,150</b>			22.8%
<b>UK Infrastructure</b>											
	UK Infrastructure	£ 30,000	£ 22,596	£ 7,404	-	-	£ 8,531	£ 8,531	1.15		
<b>UK Infrastructure Total</b>		<b>£ 30,000</b>	<b>£ 22,596</b>	<b>£ 7,404</b>	<b>£ -</b>	<b>£ -</b>	<b>£ 8,531</b>	<b>£ 8,531</b>			75.3%

## Appendix 2

### Falkirk Council Pension Fund Alternative Markets Update - 31/12/15

Exchange Rates	
\$	1.4339
€	1.2965

### Alternative Assets Summary - Sterling

Manager	Commitment £ 000's	Unfunded £ 000's	(a) Cost £ 000's	(b) Return of Cost £ 000's	(c) Distrbtn Gains £ 000's	(d) Market Value £ 000's	(b + c + d) Total Value £ 000's	Total Value to Paid in Cap.
SL Capital Partners	78,673	14,865	63,809	24,334	17,172	39,271	80,777	1.27
Wilshire Associates	58,620	12,390	46,230	20,114	15,646	30,787	66,547	1.44
Grosvenor Capital	55,792	5,518	50,274	10,510	10,061	43,682	64,254	1.28
M & G	21,835	6,034	15,801	6,556	89	11,449	18,094	1.15
Hearthstone plc	30,000	6,850	23,150	0	0	23,150	23,150	1.00
UK Infrastructure	30,000	22,596	7,404	0	0	8,531	8,531	1.15
	<b>£274,920</b>	<b>£68,253</b>	<b>£206,668</b>	<b>£61,514</b>	<b>£42,968</b>	<b>£156,870</b>	<b>£261,353</b>	

Allocation to Private Equity  
(based on unfunded commitment plus market value) 5.7%

Allocation to Private Equity  
(based on market value only) 4.1%

Allocation to Infrastructure  
(based on unfunded commitment plus market value) 4.7%

Allocation to Infrastructure  
(based on market value only) 3.1%

## Appendix 3

### Falkirk Council Pension Fund Alternative Markets Update - 31/12/15

#### Alternative Assets Calls and Distributions - Original Currency

SL Capital	Currency	in '000	2014				
			Q1	Q2	Q3	Q4	Total
	EUR	Capital calls	(2,036)	(1,418)	(1,454)	(3,267)	(8,175)
	EUR	Distributions	1,868	2,070	2,909	7,167	14,014

	Currency	in '000	2015				
			Q1	Q2	Q3	Q4	Total
		Capital calls	(1,537)	(1,243)	(1,389)	(2,868)	(7,037)
		Distributions	2,426	3,207	5,313	6,198	17,144

Wilshire Associates	Currency	in '000	2,014				
			Q1	Q2	Q3	Q4	Total
	EUR	Capital calls	(36)		(182)	(221)	(439)
	EUR	Distributions	394	767	818	686	2,665
	USD	Capital calls	(546)	(2,172)	(703)	(1,504)	(4,925)
	USD	Distributions	1,505	2,521	2,993	2,095	9,114

	Currency	in '000	2,015				
			Q1	Q2	Q3	Q4	Total
		Capital calls	(36)				(36)
		Distributions	188	244	342	1,032	1,806
		Capital calls	(300)	(889)	(629)	(835)	(2,653)
		Distributions	1,509	2,687	2,763	1,707	8,666

Grosvenor	Currency	in '000	2,014				
			Q1	Q2	Q3	Q4	Total
	USD	Capital calls	(4,470)	(3,008)	(4,916)	(1,316)	(13,710)
	USD	Distributions				7,153	7,153

	Currency	in '000	2,015				
			Q1	Q2	Q3	Q4	Total
		Capital calls	(2,266)	(239)	(1,615)	(1,393)	(5,513)
		Distributions	920	7,653		4,403	12,976

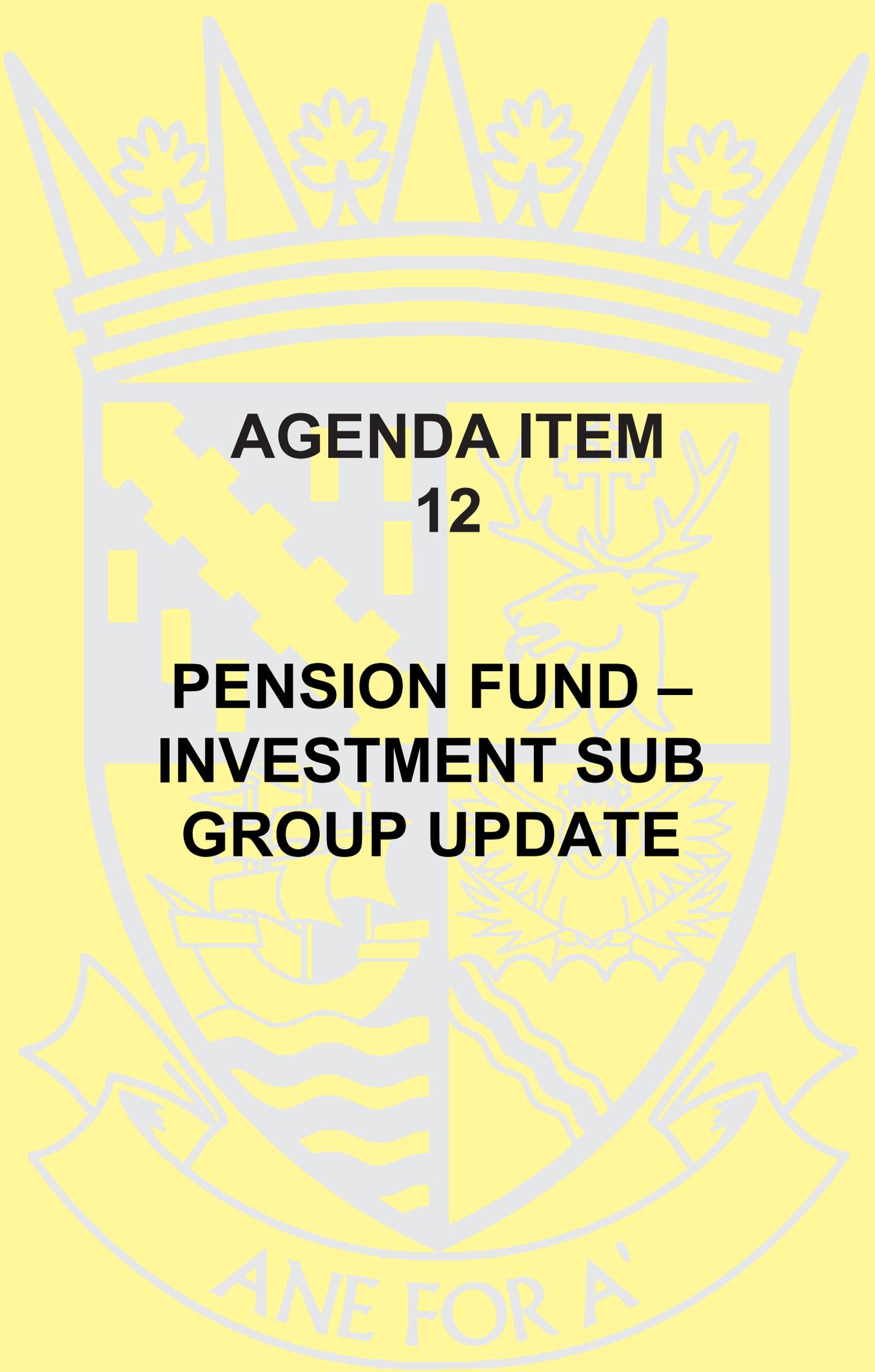
M&G	Currency	in '000	2,014				
			Q1	Q2	Q3	Q4	Total
	GBP	Capital calls	(580)	(290)	(387)	(290)	(1,547)
	GBP	Distributions		2,220		312	2,532

	Currency	in '000	2,015				
			Q1	Q2	Q3	Q4	Total
		Capital calls		(371)			(371)
		Distributions		331		1,364	1,695

UK Infrastructure	Currency	in '000	2,014				
			Q1	Q2	Q3	Q4	Total
	GBP	Capital calls					0
	GBP	Distributions					0

	Currency	in '000	2,015				
			Q1	Q2	Q3	Q4	Total
		Capital calls		(4,898)	(1,845)	(887)	(7,630)
		Distributions			173		173



**AGENDA ITEM**

**12**

**PENSION FUND –  
INVESTMENT SUB  
GROUP UPDATE**

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**FALKIRK COUNCIL**

**Subject: PENSION FUND – INVESTMENT SUB GROUP UPDATE**  
**Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE & PENSION BOARD**  
**Date: 11 MARCH 2015**  
**Author: DIRECTOR OF CORPORATE & HOUSING SERVICES**

**1. INTRODUCTION**

1.1 The purpose of this report is to provide the Pensions Committee and Pension Board with information regarding the Investment Sub Group.

**2. INVESTMENT SUB GROUP**

2.1 The sub group has met on 5 separate occasions.

2.2 Depending on how the Committee wishes to take forward the Fund's review of investment strategy, there may be no requirement for a further meeting of the sub group.

2.3 On that basis, the minutes of the sub group meeting of 28 January 2016 are attached as an appendix to this report.

2.4 A series of recommendations flowing from the work of the sub group is included in a separate report on the agenda under private business.

**3. RECOMMENDATION**

3.1 The Committee and Board are invited to note the report.

pp Director of Corporate & Housing Services

Date: 2 March 2016

Contact Officer: Alastair McGirr

**LIST OF BACKGROUND PAPERS**

NIL

**FALKIRK COUNCIL**

**MINUTE of MEETING of the PENSIONS COMMITTEE INVESTMENT REVIEW SUB GROUP in the MUNICIPAL BUILDINGS, FALKIRK on THURSDAY 28 JANUARY 2016 at 10.00 AM.**

**SUB GROUP MEMBERS:**

Committee:  
Councillor Tom Coleman, Falkirk Council  
Councillor Callum Campbell, Stirling Council (Convener)  
Andrew Douglas, Unison

Officers:  
Bruce Miller, Investment Manager, Lothian Pension Fund  
Alastair McGirr; Pensions Manager  
Bryan Smail, Chief Finance Officer

**ATTENDING:**

Pensions Board:  
Jennifer Welsh, SEPA

**ALSO ATTENDING:**

Simon Jones and William Marshall, Hymans Robertson  
Antonia Sobieraj, Committee Services Officer

**INV36. CONVENERSHIP OF MEETING**

The Clerk presided at the start of the meeting in the absence of the Convener and invited a member of the Committee to take the Chair for the duration of the meeting. Councillor Callum Campbell, Stirling Council thereafter took the Chair with the consent of members present.

**INV37. APOLOGIES**

Apologies were intimated on behalf of Depute Provost Patrick, Sandy Harrower, UCATT and Councillor Archie Drummond, Clackmannanshire Council.

**INV38. DECLARATIONS OF INTEREST**

No declarations were made.

**INV39. MINUTE**

**Decision**

The minute of the meeting of the Pensions Committee Investment Review Sub Group on 2 October 2015 was approved.

## **INV40. REVIEW OF PROGRESS TO DATE**

The Sub Group considered a report by Director of Corporate and Housing Services on the review of progress of the work of the Sub Group reviewing the Pension Fund's Investment Strategy.

The Sub Group had met on four occasions between August and October 2015. The report highlighted:-

- The Sub Group's Terms of Reference;
- The previously agreed short and long term funding objectives; and
- The key conclusions of the Group so far agreed as follows:-
  - an initial reduction of 5% in Fund equities although how and from where was still to be determined;
  - to run down the existing private equity programme;
  - to progress a Smart Beta investment from cash resources;
  - to progress the allocation to global infrastructure (with Grosvenor Capital) and UK infrastructure (with the Lothian Pension Fund);
  - not to progress Currency Hedging; and
  - to potentially increase the property allocation but with regard to the Schroders position.

The Pensions Committee in December 2015 had agreed to progress the infrastructure proposal, committing \$80m to the new Grosvenor Fund and a further £30m to UK infrastructure in collaboration with Lothian Pension Fund. It was anticipated that the fifth meeting of the Sub Group would draw together the strands from earlier meetings and make recommendations to the Pensions Committee in accordance with the terms of reference.

The key decisions/actions which were considered as outstanding were as undernoted:-

- The finalisation of the high level Fund Investment Strategy;
- The finalisation of the revised Asset Allocation;
- The determination of the extent and nature of a Smart Beta investment;
- The review of Manager deployment including opportunities for collaboration;
- The review of options for property;
- The agreement of a broad de-risking timetable; and
- The agreement of an approach to the social, environmental and governance issues (ESG).

A training session for the Committee and Board including a briefing on the technical aspects of the above issues would take place on 3 March 2016.

### **Decision**

#### **The Sub Group:-**

- (1) **noted the report; and**

- (2) agreed, depending on the outcome of discussions at the meeting of the Pensions Committee and Board on 11 March 2016, to arrange a final meeting of the Group following the Conference on 14 April 2016.

#### **INV41. FURTHER CONSIDERATION OF STATUS OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) MATTERS**

The Sub Group considered a report by the Director of Corporate and Housing Services on responsible investment, Fiduciary Duty and the environmental, social and governance (ESG) content of the Fund's Statement of Investment Principles (SIP).

The report highlighted the Fund's investment being governed by the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 including the undernoted requirements:-

- The written statement of investment principles (the "SIP") specifying the extent to which social, environmental or ethical considerations were taken into account in the selection and retention of investments;
- The need to take proper advice in determining investment policy and the formulation of policy with a view to the advisability of investing in a "wide variety of investments" and the suitability of particular investments and types of investments; and
- The fiduciary duty to Fund stakeholders to ensure that those who make decisions regarding other persons' monies acted selflessly, responsibly and with prudence in the interests of stakeholders and thereby putting aside their own personal views and interests.

The Fund's present legal and fiduciary obligations were noted and formal comment on Scottish Government responsibilities would be forthcoming in late 2016. Should Pensions Funds be given greater scope to disinvest at that time it would be possible at that stage to amend investment mandates. The revision to the Fund's approach to ESG matters could then be reflected in an update to the SIP.

Further consideration of the issue would take place at the Pension and Board Training event on 3 March and at the Annual Conference on 14 April 2016.

#### **Decision**

**The Sub Group noted the report.**

Bryan Smail left the meeting during consideration of the following item of business.

#### **INV42. INVESTMENT STRATEGY REVIEW SUMMARY**

The Sub Group considered a report by Hymans Robertson summarising the considerations during recent meetings in the development of a suitable long-term investment strategy for the Fund.

The report detailed:-

- The long and short terms investment objectives;
- The long term investment strategy including the Fund's long-term "Steady State" strategy target;
- The de-risking to the "Steady State" strategy
- The investment strategies - current, proposed and "Steady State";
- The potential for a de-risking framework",
- The investment issues reviewed to date;
- The equity structure;
- The bond/debt investment;
- The property and Infrastructure considerations;
- The currency hedging;
- The statement of investment beliefs; and
- The next steps forward.

### **Decision**

**The Sub Group noted the report.**

## **INV43. EQUITY STRUCTURE**

The Sub Group considered a report by Hymans Robertson on the development of the Fund's equity structure.

The report highlighted:-

- The appropriate "smart-beta" strategy or strategies;
- The issues for consideration relating to different approaches;
- The selection of a suitable manager in line with the chosen strategy;
- The merits of utilising existing relationships, including both the Legal and General Investment Management (LGIM) and the Shared Services arrangement with Lothian Pension Fund;
- The potential changes to the regional equity allocation within the LGIM mandate; and
- The equity allocation within the investment strategy.

The report indicated that further consideration of an appropriate "smart-beta" strategy or strategies would take place at the training session on 3 March 2016. Thereafter consideration would follow in relation to the selection of a suitable manager.

### **Decision**

**The Sub Group noted the report.**

## **INV44. PROPERTY UPDATE**

The Sub Group considered a report by Hymans Robertson on the potential evolution of the property allocation.

The Fund currently had a target allocation of 10% of assets to property. The Fund at 30 September 2015 had £139m, equivalent to around 8% of assets, invested in a mandate managed by Schroder Investment Management.

The report highlighted:-

- The current portfolio including the structure/risk profile, the manager conflict of interest and the illiquidity of the asset;
- The update on the staffing structure at Schroder Investment Management;
- The strategic allocation to property in line with its long-term target allocation of 15% to property;
- The appropriateness of continuing to pursue outperformance within the core balanced portfolio;
- The immediate short terms options to be considered to maintain the management of the current portfolio including:-
  - Retaining Schroder Investment Management;
  - Appointing different Multi Manager; and
  - Managing the existing indirect allocation in house through the Shared Services Agreement with Lothian.

The report recommended the following measures subject to undertaking due diligence:-

- the short term consideration take place to extending the current Shared Services agreement with Lothian Pension Fund to provide oversight of the current property allocation; and
- that in the long-term consideration take place on further collaboration opportunities to facilitate the migration of the current property allocation towards direct investment.

### **Decision**

**The Sub Group:-**

- (1) noted the report; and**
- (2) agreed:-**
  - (a) that in the short term consideration take place on extending the current Shared Services agreement with Lothian Pension Fund to provide oversight of the current property allocation; and**
  - (b) that in the long-term consideration take place on further collaboration opportunities to facilitate the migration of the current property allocation towards direct investment.**

**INV45. DATES OF NEXT MEETING**

The date for the next meeting of the Sub Group would if required be confirmed in due course and take place following the Conference in April 2016.