Pensions Committee

2.00 p.m., Tuesday, 6 December 2016

Service Plan Update

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide an update on progress against the 2016– 2018 Service Plan, performance indicators and the key actions to enable the Fund to meet its four key objectives:

- Customer First;
- Honest & Transparent;
- Working Together; and
- Forward Thinking.

Overall progress is being made against the service plan objectives.

Most performance indicators are meeting targets. However, staff training and customer satisfaction are both marginally behind target. Whilst only halfway through the year, it is likely that the staff training indicator will be met. However, it is possible that the customer satisfaction target will not be achieved by the end of the year.

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Report

Service Plan Update

Recommendations

Committee is requested to:

1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider;

1.2 Note the progress of the Fund against the 2016-2018 Service Plan;

1.3 Note the responses on the issue of the full cost transparency of investment management fees from CIPFA and the Scheme Advisory Board.

Background

2.1 The purpose of this report is to provide an update on the 2016 – 2018 Service Plan, performance indicators and the key actions to enable the Fund to meet its four key objectives:

- Customer First;
- Honest & Transparent;
- Working Together; and
- Forward Thinking.

Main report

3.1 Progress is being made against the service plan. The following areas are covered elsewhere on the agenda for Committee and the Audit Sub-Committee:

- Cost benchmarking
- Stewardship.

Other progress of particular note is shown below.

3.2 **Preparation for the 2017 actuarial valuation:** Following the review of the Contribution Stability Mechanism by Committee in September, preparations continue:

- **Unitisation**: Implementation of the new HEAT system is progressing well. The 2017 actuarial valuation results for individual employers will be based on this information and details of the system will be provided to employers with the draft results later in 2017. HEAT has two main purposes: improving the triennial actuarial valuations in terms of speed of preparation and accuracy; and allowing appropriate investment strategies to be applied to individual employers.

- **Employer Covenant Analysis**: A questionnaire has been issued to the employers in the Fund for completion by the end of November. This will enable covenant analysis to be undertaken which will be a consideration in setting contributions at the valuation.
- **Employer Annual Meeting**: The annual briefing for employers is scheduled to be held in December. The agenda includes an update from the Actuary on funding since the 2014 actuarial valuation, the Contribution Stability Mechanism and the covenant analysis. Other topics include the legal opinion on fiduciary duty issued by the Scheme Advisory Board and Brexit.
- **Employer Cessation Debt**: The Fund continues to engage with a number of smaller employers regarding a potential funding agreement to repay cessation debt. As previously agreed by Committee, the agreement aims to avoid employer default or insolvency but will allow for repayment over longer terms, and if necessary for repayment of less than the cessation debt.
- **Scottish Homes Pension Fund:** Meetings have been held with the Actuary and investment adviser to pursue the review of the funding arrangement. Liability cashflow projections are currently being updated and a meeting scheduled with Scottish Government in December.

3.3 **Monitoring of Additional Voluntary Contribution (AVC) Providers:** The Fund is due to report to the Investment Strategy Panel on its annual review of the AVC providers.

3.4 **Staffing:** There have been a number of recent staffing changes which are outlined below. Staffing costs remain within the agreed budget:

- In 2015, data quality improvement efforts were consolidated into a Data Quality team for a trial period to deal with increasing data requirements arising from greater scrutiny from the Pensions Regulator and the new career average scheme. The work undertaken by the team has proved to be extremely worthwhile, resulting in the majority of employers sending us monthly contribution breakdown and over 99% of annual benefit statements being issued before the regulatory deadline. However, efforts need to continue and therefore a post of Deputy Pensions Operations Manager has been advertised on a permanent basis.
- Following successful completion of the training and examinations by trainee pensions administrators, plans are in place to recruit two further trainee pension administrators.
- It has been agreed that as part of the Council's Legal trainee rotation, they will spend time with the Fund and a trainee joined the Fund in October.

- An appointment has been made for the vacancy of a Portfolio Manager in the investment team. The new member of staff will commence in January 2017.

3.5 **Pension Board insurance liability:** Further to the Committees previous consideration of this matter in September and the legal opinion given to the Local Government Association (LGA), the Fund has researched the insurance market to provide a further update for the Committee and Pension Board. The Fund has identified two insurance groups that are considering insurance liability for Pension Board Members, AON and Zurich. Zurich are currently working on a solution for Local Government Pension Boards. The view from their insurer is that although the legal relationships are now understood the risk exposure seems very limited. They are also researching whether insurance cover would actually address the risk of exposure to Pension Board Members, for example, if a fine was imposed by the regulator the insurance policy may not limit the exposure because, in general, fines are uninsurable. Zurich are continuing to work on this and to consider all the options including the extension to existing corporate insurance programmes of the administering authority. They will notify the fund of the outcome of the research. AON has offered some cover, however, because the risk is unknown the premium is high. Like Zurich, AON also concede that the risk is viewed as remote however Pension Boards are new therefore their underwriters have taken a cautious approach. Overall insurance options are currently very limited. A further update will be provided to Committee when there is a further update from Zurich.

3.6 **Investment management fees – full cost transparency :** The Fund is committed to full cost transparency and at its meeting on 28 September 2016, the Pensions Committee agreed to communicate to the Chartered Institute of Public Finance and Accountancy (CIPFA), Audit Scotland and the Scheme Advisory Board (of the Local Government Pension Scheme in Scotland), the Committee's and Convenor's disquiet with the relaxation of the principle of full cost transparency of investment management fees, as explicit in CIPFA's revised guidance "Accounting for Local Government Pension Scheme Management Costs", dated March 2016. Responses have been received from Mike Ellsmore, Chair, CIPFA Pensions Panel and from the Scheme Advisory Board. These are shown in full at Appendices 2 and 3. A reply from Audit Scotland is awaited and Committee will be advised in due course

The substance of the response from CIPFA is not unexpected in that it reiterates their assertion that certain indirect investment management fees do not meet the International Financial Reporting Standards (IFRS) definition of liabilities. As Committee is aware, this opinion is not shared by Lothian Pension Fund.

Following receipt of the letter from the Scheme Advisory Board, they wrote to all Scottish pension funds endorsing a Code of Transparency for asset managers which has been the equivalent board in England and Wales, requesting that pension funds promote the use of the Code. The communication can be found on their website http://lgpsab.scot/circular-012016-transparency-code/

Performance Indicators

3.7 Performance Indicators for the first two quarters of the financial year are provided in the attached appendix.

3.8 Only two indicators are highlighted as ‘amber’:

- The staff training indicator shows that 75% of staff had completed their pro-rata training target up to 30 September 2016. The Fund is comfortable that the target should be achieved by the end of the year.
- Customer satisfaction for the 12 months to 30 September is marginally behind target (87.7% compared to 88%). 87.7% is the average of satisfaction of pensioners (89.6%), employers (85.7%) and members’ satisfaction with specific transactions (71.6%). The lower satisfaction with transactions is primarily due to email service and efforts are continuing to improve this aspect of the service. Further, the response rate from new members is currently very low and efforts are ongoing to get more feedback from these customers as well as encouraging use of the on-line system. Plans are also in place to survey members who have contacts the Fund via telephone survey and those whose complaints have been upheld and these will be included in the overall satisfaction in future.

3.9 Since 30 September, the Fund has completed the annual pensioner and employer surveys and the results will be included in the performance indicators in the next report to Committee.

3.10 There were over 1,000 responses to the pensioner survey, which is more than double that in 2015. Overall results were very good, 91% were satisfied with how the Fund with their query, 85% found the information provided by the fund easy to understand and 87% found the website easy to use. However, overall satisfaction was behind target at 85.2%. There were 157 positive comments including ‘I can't praise LPF enough’ and ‘fund is very efficient’. There were also 66 negative comments regarding the retirement process, monthly payslips and the online service. The Fund is working with our pension online service provider to improve member experience. 22 of the negative comments were specifically about Club Together mailing which is an arrangement which has been in place for 4 years whereby Club Together issues their magazine and associated offers to retired members, alongside the Fund’s newsletter. In October Club Together informed the Fund that they were ceasing trading and therefore additional postage costs of £10K have been incurred. This is being contained within the current budget for 2016/17 and mailing options are being reviewed to contain costs in the future.

3.11 The annual survey for employers shows satisfaction of 96.3%. The detailed results are currently being analysed and will be reported to Committee in March 2017.

Membership and Cashflow monitoring

3.12 Officers of the Fund continue to monitor movements in membership numbers in order to assess potential implications upon cashflow. Early retirement initiatives could trigger significant and immediate outflows due to the payment of tax free lump sums and pensions and reductions in contributions received. However payment of strain costs by the employer helps to mitigate current cashflow pressures.

3.13 The summary below details the cash flows as at the end of September and projections for the financial year. This has been prepared on a cash flow basis (compared to the accruals basis of the year end financial statements and budget projections).

Lothian Pension Fund	**2016/17 YTD**	**2016/17 Projected**
Income	**£'000**	**£'000**
Contributions from Employers	69,830	145,000
Contributions from Employees	19,950	40,000
Transfers from Other Schemes	2,235	4,700
	92,015	**189,700**
Expenditure		
Pension Payments	(69,785)	(142,000)
Lump Sum Retirement Payments	(33,800)	(60,000)
Refunds to Members Leaving Service	(435)	(800)
Transfers to Other Schemes	(4,000)	(8,000)
Administrative expense	(950)	(1,865)
	(108,970)	**(212,665)**
Net Additions/(Deductions) From Dealings with Members	**(16,955)**	**(22,965)**

Lothian Buses Pension Fund	**2016/17 YTD**	**2016/17 Projected**
Income	**£'000**	**£'000**
Contributions from Employers	3,775	7,600
Contributions from Employees	1,055	2,100
Transfers from Other Schemes	10	30
	4,840	**9,730**
Expenditure		
Pension Payments	(4,185)	(8,450)
Lump Sum Retirement Payments	(1,880)	(3,500)
Refunds to Members Leaving Service	(10)	(25)
Transfers to Other Schemes	(95)	(72)
Administrative expense	(58)	(112)
	(6,228)	**(12,159)**
Net Additions/(Deductions) From Dealings with Members	**(1,388)**	**(2,429)**

Scottish Homes Pension Fund	2016/17 YTD	2016/17 Projected
Income	**£'000**	**£'000**
Contributions from Employers	**675**	**675**
Expenditure		
Pension Payments	(3,412)	(6,880)
Lump Sum Retirement Payments	(261)	(520)
Transfers to Other Schemes	(58)	(100)
Administrative expense	(25)	(55)
	(3,756)	**(7,555)**
Net Additions/(Deductions) From Dealings with Members	**(3,081)**	**(6,880)**

3.14 Owing to the City of Edinburgh Council's ongoing transformation project, there continues to be a significant number of leavers. As a result, it is expected that Lothian Pension Fund will have a negative cash flow position at the end of the year, whereby pension payments exceed total contributions received. The Fund has targeted increased investment income in recent years which is expected to exceed net cashflow for the foreseeable future. It is therefore not anticipated that the sale of assets will be required to meet this funding requirement.

3.15 In Lothian Buses and Scottish Homes Pension Funds, expenditure is anticipated to continue to exceed income. A combination of investment income and asset sales are used to fund this shortfall.

Measures of success

4.1 Measures of success include meeting targets for performance indicators and progressing the actions set out in the Service Plan.

Financial impact

5.1 A summary of the projected and year-to-date financial outturn compared to the approved budget for 2016/17 is shown in the table below:

Category	Approved Budget £'000	Projected Outturn £'000	Projected Variance £'000	Budget to date £'000	Actual to date £'000	Variance to date £'000
Employees	2,906	2,500	(406)	1,453	1,228	(225)
Transport & Premises	236	254	18	118	130	12
Supplies & Services	1,195	1,180	(15)	598	550	(48)
Investment Managers Fees	7,120	5,000	(2,120)	3,560	2,400	(1,160)
Other Third Party Payments	1,375	1,125	(250)	687	253	(434)
Central Support Costs	300	300	-	150	150	-
Depreciation	87	88	1	44	44	-
Direct Expenditure (Invoiced)	**13,219**	**10,447**	**(2,772)**	**6,610**	**4,755**	**(1,855)**
Income	(977)	(788)	189	(489)	(477)	12
Net Expenditure (Invoiced)	**12,242**	**9,659**	**(2,583)**	**6,121**	**4,278**	**(1,843)**
Indicative Expenditure (Uninvoiced)	**18,800**	**19,050**	**250**	**9,400**	**9,400**	**-**
Total Cost to the Funds	**31,042**	**28,709**	**(2,333)**	**15,521**	**13,678**	**(1,843)**

5.2 Year to date actual expenditure includes provision for services incurred but for which no invoice has yet been received. Uninvoiced expenditure (i.e. investment management costs deducted from capital) is generally assumed to be in-line with the budget. With delays experienced in separating research costs from brokers fees (see below) a £250k overspend in uninvoiced fees has been forecast.

5.3 The key variances for each category in the budget are:

- Investment Managers Fees - **£2,120k underspend**. The budget for external fund management costs was set prior to the in-sourcing of a global equity portfolio in March 2016.
- Employees **- £406k underspend**. This is mainly due to unfilled posts across the division during the period from April to September 2016. Recruitment processes are progressing as outlined above.
- Other Third Party Payments **- £250k underspend**. Underspend due to delays in the separating research costs from brokers' fees. As mentioned above these costs have been offset in the Uninvoiced expenditure.
- Transport & Premises - **£18k overspend**. A historical rates charge relating to 2013/14 has come to light which has resulted in the overspend.
- Income - **£189k below budget.** This relates to stock lending commission. The budget was modelled on the original projections by the global custodian. Following the Brexit referendum and the UK's subsequent downgrading stock lending revenue has fallen. A further update to the projection has been sought from the custodian.

Risk, policy, compliance and governance impact

6.1 The pension funds' service plan aims to manage risk, improve compliance and governance. There are no direct implications on these issues as a result of this report.

Equalities impact

7.1 None

Sustainability impact

8.1 None

Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

LPF Service Plan 2015-2018

Hugh Dunn

Acting Executive Director of Resources

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives
Single Outcome Agreement	
Appendices	Appendix 1 – Performance Indicators Appendix 2 – Investment management fees – full cost transparency, letter from Mike Ellsmore, Chair, CIPFA Pensions Panel, dated 24 October 2016 Appendix 3 – Investment management fees – full cost transparency, letter from Scottish Government Pension Scheme Advisory Board, dated 18 November 2016

Appendix 1

Service Plan Performance Indicators – Targets & Actual Performance

	Q1 April to June	Q2 July to Sept	Q3 Oct to Dec	Target	Status
Customer First					
Maintain Customer Service Excellence Standard	Annual assessment will be carried out early in 2017			Retain CSE Award	Not yet known
Overall satisfaction of employers, active members and pensions measured by surveys	Rolling 12 month performance is 87.7%			88%	
Proportion of active members receiving a benefit statement and time of year statement is issued	99.9% issued by 31 August 2016			100%	
Forward Thinking					
Performance and Risk of Lothian Pension Fund	Actual 10.4%pa, Benchmark 8.4%pa. Exceeding benchmark. Risk/return measures will take some time to demonstrate the success or otherwise of the investment strategy.			Meet benchmark over rolling 5 year periods with lower risk with risk/return measures including performance in rising and falling markets	
Proportion of critical pensions administration work completed within standards	92.4%	90.3%		Greater than 90%	
Honest & Transparent					
Audit of annual report	Achieved			Unqualified opinion	
Percentage of employer contributions paid within 19 days of month end	98.8%	99.2%		99%	
Data quality – compliance with best practice as defined by the Pensions Regulator	Assessment will be made at year-end			Fully compliant	Not yet known
Monthly Pension Payroll paid on time	Yes	Yes		Yes	
Working Together					
Level of sickness absence	0.72%	1.27%		4%	
Annual staff survey question to determine satisfaction with present job	-			75%	Not yet known
Percentage of staff that have completed two days training per year.	62.5%	75.3%		100%	

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24 October 2016

Stuart McLean
City of Edinburgh Council
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Dear Stuart,

Full cost transparency

Many thanks for your letter dated 7 October 2016 and I am sorry to hear of the Committee's disquiet over our approach to the accounting for investment management fees.

I would like to reassure the Committee that CIPFA remains committed to the cost transparency agenda for investment management expenses. The Institute has a long history of leading on improving the transparency of management costs. In 2014 the Institute published guidance, *Accounting for Local Government Pension Scheme Management Costs*. We are also very supportive of the initiative being led by the Scheme Advisory Board in England to develop a Code of Transparency for Investment Managers, which will inform the reporting and disclosure of these costs.

The 2014 CIPFA guidance in this area led to significant improvements in the reporting of management expenses particularly where Pension Funds had been previously "netting off" these costs from their investment returns. This was a positive step forward but clearly there was more that could be done and the 2016 *CIPFA Accounting for Local Government Pension Scheme Management Expenses* requires further disclosure of investment management expenses in order to identify transaction costs along with ad valorem fees and performance fees.

Local Authority Accounts (including Pension Fund Accounts) are prepared under the CIPFA Code of Practice of Practice on Local Authority Accounting in the United Kingdom (the Code) which requires preparers to 'have regard' to the Guidance on Management Expenses. The Code is based upon International Financial Reporting Standards (IFRS) which require entities to define the elements of financial reports as assets, liabilities and equity. Liabilities are defined as:

> *"….present obligations of the authority arising from past events, the settlement of which is expected to result in an outflow from the authority of resources embodying economic benefits or service potential"*

In identifying the indirect costs associated with investment management transactions it is clear that a number of these "costs" do not meet this definition and hence would not be required to be reported in the Pension Fund Accounts.

However, CIPFA does not suggest that these “costs” are unimportant and believes they should be identified and reported to all relevant stakeholders. To support this the 2016 Guidance includes a recommendation that the Pension Fund Annual Report can be used to report the costs of operating and managing the pension fund in more detail, in line with local priorities. The Guidance includes the following section on Investment Policy and performance:

> *70. The investment policy and performance section of the annual report demonstrates how the investment strategy has been put into practice during the year. Part of this is understanding the total cost of the supply chain involved in managing the pension fund’s investments, and the relationship between risk and return.*
>
> *71. Many financial instruments contain costs which will not be reported in the pension fund accounts as they do not meet the recognition criteria under the Code. However being able to identify these in order to engage with fund managers and external advisors is a key step in decision making and in delivering effective and efficient pension fund management.*
>
> *72. The level of detail reported is one for local discretion, but the aim should be to enable readers of the annual report to understand the effectiveness of the fund’s investment management arrangements by reference to the returns and risks associated with the pension fund portfolio. This should be consistent with the financial instrument risk disclosures reported in the pension fund accounts.*

CIPFA remains committed to full cost transparency to assist all stakeholders in determining the value for money of a Pension Funds investment strategy and its implementation. It will continue to support the development of the Code of Transparency, and where appropriate review the Guidance on Management Expenses to ensure this meets the expectations of the Government and regulators in this area.

I hope this provides the Committee with the reassurance that CIPFA is fully committed to the transparency agenda.

The CIPFA Pensions Panel have been made aware of your letter and this response and would be happy to engage further on this matter.

Kind Regards

Michael Ellsmore
Chair CIPFA Pensions Panel

Appendix 3

18 November 2016

Stuart McLean
Committee Clerk
Committee Services, Strategy and Insight, Chief Executive
City of Edinburgh Council

Dear Stuart

CITY OF EDINBURGH COUNCIL

Thank you for your letter of 7th October 2016 with regard to your Council's Pensions Committee. We note the decision of your Committee to communicate its concerns to CIPFA, Audit Scotland and the Scheme Advisory Board, in relation to the relaxation of the principle of full cost transparency of investment management fees.

The SAB is aware of and shares your Pension Committee's concerns that the CIPFA revised guidance is at odds with promoting greater transparency. For your information the SAB recently agreed to issue a voluntary code on transparency of investment management fees and a circular covering this has just been issued to each Pension Fund/ Committee. We have also informally given indication to Audit Scotland that we consider the revised CIPFA circular as reversing good practice around transparency and we have raised our concerns with SPPA.

We believe that a further discussion at the next SAB meeting is merited, as to any further action required, and we will ensure that this is on the agenda for their next meeting on 23rd February 2017.

We trust that this gives you assurance of the SAB's shared concerns with regard to this issue. On behalf of the SAB we are more than happy for you to make our response available at your next Pensions Committee.

Kind Regards

Jonathan Sharma
pp LGPS SAB Joint Secretaries

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