

Pensions Committee

11.00am, Wednesday, 27 September 2017

Service Plan Update

Item number	5.14
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for 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 and Transparent;
- Working Together; and
- Forward Thinking.

Overall progress is being made against the service plan objectives with all but one of performance indicators meeting the target so far for 2017/18. An underspend is projected for the financial year.

Service Plan Update

1. 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 update on the Additional Voluntary Contributions (AVCs) funds' administration service; and
- 1.4 Consider whether the services of an Independent Professional Observer will be required after February 2018.

2. 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 and Transparent;
 - Working Together; and
 - Forward Thinking.

3. Main report

- 3.1 Progress is being made against the service plan. Progress of particular note since the last service plan update in March 2017 is shown below. The following areas are covered elsewhere on the agenda:
 - Actuarial Valuation
 - Investment Strategy implementation
 - Staffing update
 - Employers participating in Lothian Pension Fund.
- 3.2 **Pension Administration Standards Association:** In April 2017, the Fund became the first Local Government Pension Scheme fund to successfully achieve Pension Administration Standards Association (PASA) accreditation. PASA promotes standards for administration services for UK pension schemes and accreditation is encouraged by The Pensions Regulator. The accreditation

covers service commitments, performance measurement and reporting, operational procedures and controls, data security and staffing, with the focus being on providing the optimal service to customers. The assessment involved an online application with documentary evidence and three-day site visit by an Independent Assessor in March. Accreditation lasts for two years.

- 3.3 **Collaboration update:** The collaboration proposals approved by the Pensions Committee in March 2017 were agreed by the City of Edinburgh Full Council in April 2017. The new model should enable further collaboration and efficiencies, working with Falkirk Pension, whilst ensuring the assets of the Funds remain separate and investment allocation decisions are retained by each Fund.

A joint Investment Strategy Panel has been set up to align governance for the investment of funds and it met in July to advise the Head of Finance of the City of Edinburgh Council and the Chief Finance Officer of the Falkirk Council. Lothian's existing independent advisers, Scott Jamieson and Gordon Bagot, are part of the Panel. A further adviser will be jointly procured to join the Panel.

Further collaboration with other funds on joint infrastructure investments is ongoing. Following the first joint investment working with Northern Ireland Local Government Officers Superannuation Committee (NILGOSC) earlier this year, Scottish Borders Pension Fund have signed an agreement to consider joint investments in the future.

- 3.4 **Petition to City of Edinburgh Council regarding Arms Investments:** A petition was considered by the Petitions Committee of the City of Edinburgh Council in March 2017. The wording of the petition was 'We call on the City of Edinburgh Council to do everything within its powers and remit to require that Lothian Pensions Trust divest from all investments concerning arms manufacture.'

The Petitions Committee referred it to the Pensions Committee for consideration. The webcast of that meeting is available on the City of Edinburgh Council's website at https://edinburgh.public-i.tv/core/portal/webcast_interactive/213716

Officers of the Fund met with the petitioners in May to listen to their views and explain the Fund's investment policy and the environment in which the LGPS operates. Issues including fiduciary duty, the Fund's long-term investment horizon, engagement with companies, member and employer involvement in Fund governance as well as renewable energy investments were discussed. Also covered was the widely-held misconception that companies would be adversely impacted by disinvestment.

- 3.5 **Annual Benefit Statements:** Employers must provide membership data to allow the Fund to meet The Pension Regulator's statutory deadline for annual benefit statements by the end of August. By the deadline of 19 April, 77 employers had provided correct data with a further 10 returned due to errors and amended data received after the deadline. A further eight employers missed the deadline, despite reminders being issued. A fine will be imposed for those who did not meet the submission deadline as set out in the Fund's Pensions Administration Strategy.

As reported to Committee in March 2017, significant additional work has been undertaken owing to unintended volatility arising from the City of Edinburgh Council use of the payroll position reference as a unique identifier for an employee's pension record. Although the problem still persists and therefore data rectification has continued in respect of 2017/18, the Council has advised that a solution is anticipated very shortly.

By the statutory deadline of 31 August 2017, 49,051 annual benefit statements were produced, representing 99.9% of records where current member address details were held. 2,232 newsletters advising of the online availability of the annual benefit statement were not issued to deferred members, owing to difficulty in tracing these individuals. These "gone aways" represent 12.6% of the deferred membership. Attempts to trace are ongoing. The 99.9% issued is deemed to meet the requirements of the Pensions Regulator, given materiality tolerance.

3.6 Additional Voluntary Contributions (AVC) – administration service: At its meeting on 20 March 2017, Pensions Committee considered a report which highlighted certain concerns regarding the administration of members' AVC funds. Specifically, "with effect from 6 April 2015, the Taxation of Pension Act 2014 granted the opportunity to access such funds to any member aged 55 or over. Any such withdrawal would be termed an "uncrystallised funds pension lump sum (UFPLS)" payment, with 25% being paid free of income tax. As at March 2017, neither AVC provider, Prudential and Standard Life, had amended its communications, nor payment processes, to enable compliance with this new flexible entitlement for members (of phased withdrawal of AVC funds). Similarly, the Pension Regulator's requirements for detailed monitoring of AVC contribution receipts required more comprehensive submissions, on a monthly basis, to the Fund from both companies. Committee noted that "that such delivery of AVC contribution monitoring and uncrystallised funds pension lump sum (UFPLS) service provision will be reviewed by the Fund and a further update provided to Committee in September 2017".

3.7 The updated position is as follows:

- a. UFPLS: Prudential has made very good progress and the expectation, at the time of writing, is that resolution has been effected during September 2017. As requested, the company will now address member requests and report directly to HMRC on taxation matters. Whilst Standard Life (now Standard Life Aberdeen plc) has accepted its responsibilities in facilitating UFPLS and has confirmed that work is ongoing, it has not yet indicated that necessary revision to its administrative processes is complete.
- b. Contribution monitoring: Standard Life is now fully compliant. Prudential, also, is now providing monthly member and employer level reports, which are sufficient for the Fund to meet the requirements of the Pensions Regulator. Prudential has committed to refine its reports to improve overall efficiency.

3.8 Pension Board insurance liability: Further to the Committee's previous consideration of this matter in December 2016, arrangements are now in place to cover the insurance liability of the Pension Board.

3.9 **Independent Professional Observer:** Following a competitive selection process in March 2013, Sarah Smart of SmartCats Consulting was appointed by Committee as the Independent Professional Observer who would participate in and enhance the governance arrangements for the Lothian Pension Fund. The duration of the appointment was for an initial 3-year term and in March 2016 the discretionary two-year extension was exercised. This means that the appointment will expire on 28 February 2018.

Under the current arrangements, the role of the Independent Professional Observer includes:

- attending all meetings of the Pensions Committee in Edinburgh
- reviewing and giving feedback on all draft Committee papers (including Audit Sub-Committee papers)
- holding a surgery prior to each Committee meeting
- providing assistance to the Committee and Board in questioning and challenging professional advice
- consulting with members of the Committee on an ad-hoc basis in between meetings, to the extent required/necessary
- participating in 2 half-day training sessions per year.

Committee is asked to consider whether it would like the services of an Independent Professional Observer after March 2018. It is recommended that such appointment be continued, it being noted that the role of the Independent Professional Observer has been invaluable to the proper governance of the Fund and provides significant comfort to Committee by better equipping them with knowledge in order to make informed decisions and challenge advice. This is important from a risk perspective. If Committee agree that they require the service a tender will take place over the coming months.

Other collaborative partners of Lothian Pension Fund are aware of the role carried out by the Independent Professional Observer and depending on the Committee's interest and any timing issues, the collaborative partners may wish to participate in a joint appointment.

3.10 **Scottish Government's Public Sector Pensions Governance Review:** A review of the new public sector pensions governance arrangements which were put in place in 2015, was undertaken earlier this year by KPMG on behalf of Scottish Government. The timing of the next stage of this review, and Scottish Government's views on KPMG's recommendations, are not yet known.

3.11 **Awards:** At the Professional Pensions awards held in June 2017, the Fund won Fund of the Year 2017 (Under £750m) Award for Lothian Buses Pension Fund and was highly commended for the Lothian Pension Fund in the Fund of the Year 2017 (over £5bn) category. The Fund has also been shortlisted for 8 categories in the LAPF Investment Awards held on 19 September. A verbal update will be provided at the Committee meeting.

Performance Indicators

3.12 Performance indicators for the first quarter of the 2017/18 financial year are provided in the attached appendix.

One indicator is highlighted as ‘amber’:

- 39.6% of staff have completed their pro-rata training target up to 30 June 2017. The Fund is comfortable that this is a relatively short period over which training has been measured and the target should be achieved by the end of the year.

Membership and Cashflow monitoring

3.13 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 help to mitigate current cashflow pressures.

3.14 The table below details the cashflows as at the end of July and projections for the financial year. This has been prepared on a cashflow basis (compared to the accruals basis of the year-end financial statements and budget projections).

Lothian Pension Fund	2017/18 YTD	2017/18 Projected
<u>Income</u>	£'000	£'000
Contributions from Employers	44,800	140,000
Contributions from Employees	13,885	35,100
Transfers from Other Schemes	1,613	4,700
	60,298	179,800
<u>Expenditure</u>		
Pension Payments	(49,208)	(148,000)
Lump Sum Retirement Payments	(18,894)	(48,000)
Refunds to Members Leaving Service	(197)	(630)
Transfers to Other Schemes	(4,096)	(12,100)
Administrative expenses	(740)	(2,221)
	(73,135)	(210,951)
Net Additions/(Deductions) From Dealings with Members	(12,837)	(31,151)

Lothian Buses Pension Fund	2017/18 YTD	2017/18 Projected
<u>Income</u>	£'000	£'000
Contributions from Employers	2,516	7,320
Contributions from Employees	662	1,860
Transfers from Other Schemes	-	-
	3,178	9,180
<u>Expenditure</u>		
Pension Payments	(2,883)	(8,740)
Lump Sum Retirement Payments	(1,129)	(3,000)
Refunds to Members Leaving Service	(1)	(18)
Transfers to Other Schemes	(265)	(330)
Administrative expenses	(21)	(85)
	(4,299)	(12,173)
Net Additions/(Deductions) From Dealings with Members	(1,121)	(2,993)

Scottish Homes Pension Fund	2017/18 YTD	2017/18 Projected
<u>Income</u>	£'000	£'000
Contributions from Employers	675	675
<u>Expenditure</u>		
Pension Payments	(2,242)	(7,330)
Lump Sum Retirement Payments	(331)	(916)
Transfers to Other Schemes	(30)	(75)
Administrative expenses	(19)	(60)
	(2,622)	(8,381)
Net Additions/(Deductions) From Dealings with Members	(1,947)	(7,706)

- 3.15 The Fund reduced equity risk over the period around the UK's referendum on EU membership by selling a portion of its equity exposure and reinvesting it in bond futures contracts. This "hedge" contributed 0.1% to the excess return at the Total Fund level despite being in place for just a short (10 day) period.
- 3.16 In 2016/17 Lothian Pension Fund had a negative cash flow position, whereby pension payments exceed total contributions received. This is a trend that is likely to continue for the foreseeable future. Increased investment income has been targeted in recent years for this scenario, which is expected to exceed net cashflow for the long term.
- 3.17 It is expected that the number of active members for Lothian and Lothian Buses Pension Funds will continue to decrease during the year, causing a fall in contributions and increase in pension and lump sum payments. Lothian Buses fall

in active membership is likely to be at a higher rate than Lothian due to being closed to new members.

- 3.18 All three Funds' expenditure cashflows are anticipated to continue to exceed cashflow income.

4. Measures of success

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

5. Financial impact

- 5.1 A summary of the projected and year-to-date financial outturn compared to the approved budget for 2017/18 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	3,009	2,715	(294)	1,003	859	(144)
Transport & Premises	242	242	-	81	76	(5)
Supplies & Services	1,232	1,232	-	411	348	(63)
Investment Managers Fees	5,200	5,200	-	1,733	1,650	(83)
Other Third Party Payments	1,392	1,267	(125)	464	225	(239)
Central Support Costs	286	286	-	95	95	-
Depreciation	82	82	-	27	27	-
Direct Expenditure (Invoiced)	11,443	11,024	(419)	3,814	3,280	(534)
Income	(727)	(977)	(100)	(242)	(501)	(259)
Net Expenditure (Invoiced)	10,716	10,047	(519)	3,572	2,779	(793)
Indicative Expenditure (Uninvoiced)	17,100	17,100	-	5,700	5,700	-
Total Cost to the Funds	27,816	27,147	(519)	9,272	8,479	(793)

- 5.2 The financial outturn includes year to date budget, actual expenditure and variance as at the end of July 2017. 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 assumed to be in-line with the budget.
- 5.3 The projection shows an underspend of approximately £519k. The key variances against budget are:

- **Employees - £294k underspend.** This is mainly due to unfilled posts across the division during the period from April to July 2017. Within the Investment team there is a vacant Portfolio Manager post, following a resignation earlier in 2017, and two new Investment Analysts posts. It has been assumed that these posts will not be filled till January 2018.
- **Other Third Party Payments - £125k underspend.** This is primarily due to delays in splitting out research costs from broker's fees. Progress has been made in splitting out these fees prior to MiFID regulations come into force which makes this a requirement.
- **Income - £100k above budget.** Stock lending commission income has been higher than originally projected. The Fund's custodian had highlighted that securities lending could become less profitable with tighter regulations coming into fruition but this has yet to impact income.

5.4 An outline business case on the Fund's ongoing collaboration work with other LGPS administering authorities was approved by Committee in March 2017. The requisite adjustments to the service plan budget are shown below:

Category	Approved Budget £'000	Business Case adjustments £'000	Description
Employees	3,009	201	Increased staffing resources including a Service Development Manager and an additional Investment Analyst and Administrator
Supplies & Services	1,232	222	Includes costs associated with the procurement of an Investment Front Office System and the transfer of remaining staff into LPFE Ltd.
Other Third Party Payments	1,392	152	Includes £110k of one off revenue costs for services/advisers for due diligence on the legal collaboration structure.
Income	(727)	(583)	Increased revenue from the expansion of services to other Funds.

5.5 The above changes have not yet been integrated into the budget. The following progress has been made during the year with actual year to date spending being below £20k –

- **Employees** – An Investment Administrator has been hired on a 3 month contract to assist with additional workloads. Recruitment of permanent staff will commence once LPF current staff are transferred to LPFE Ltd.
- **Supplies and Services** – The transfer of remaining staff to LPFE Ltd has been targeted for the 1st November 2017 with a payroll and time recording system in the process of being implemented. Procurement for an Investment Front Office System is underway.
- **Income** – The Fund's collaboration work with Northern Ireland Local Government Officers Superannuation Committee continues with co-investments completed in May 2017 and discussions continuing with a number of Scottish LGPS Funds'. Increased synergy has been approved by

Falkirk Council Pension Fund's committee to include a shared Investment Strategy Panel.

6. 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.

7. Equalities impact

- 7.1 None.

8. Sustainability impact

- 8.1 None.

9. Consultation and engagement

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

10. Background reading/external references

- 10.1 [LPF Service Plan 2016-2018](#)

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11. Appendices

Appendix 1 – Service Plan Performance Indicators

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 2018			Retain CSE Award	Not yet known
Overall satisfaction of employers, active members and pensions measured by surveys	Rolling 12-month performance is 90.5% to end June 2017			89%	
Proportion of active members receiving a benefit statement and time of year statement is issued	100.0% issued by 31 August 2017			100%	
Forward Thinking					
Performance and Risk of Lothian Pension Fund	Actual 10.4%pa, Benchmark 8.4%pa. Exceeding benchmark with lower risk.			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	95.1%			Greater than 90%	
Honest & Transparent					
Audit of annual report	Achieved			Unqualified opinion	
Percentage of employer contributions paid within 19 days of month end	99.74%			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	
Working Together					
Level of sickness absence	0.45%			4%	
Annual staff survey question to determine satisfaction with present job	Staff survey will be undertaken later in the year			77%	Not yet known
Percentage of staff that have completed two days training per year.	35.63%			100%	