North Yorkshire County Council

Pension Fund Committee

Minutes of the meeting held on 14 September 2017 at County Hall, Northallerton commencing at 10.00 am.

Present:-

County Councillors John Weighell OBE (Chairman), John Blackie, Michael Chambers, MBE, Cliff Lunn (as substitute for Richard Musgrave), Patrick Mulligan, Andy Solloway, Helen Swiers and Angus Thompson.

David Portlock – Chair of the Pension Board.

Apologies - Councillor Jim Clark - North Yorkshire District Councils

There were no members of the public present.

The Chairman introduced the new representatives of AON Hewitt, the Fund's Investment Consultants.

Copies of all documents considered are in the Minute Book

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17. Minutes

Resolved -

That the Minutes of the meeting held on 6 July 2017, having been printed and circulated, be taken as read and be confirmed and signed by the Chairman as a correct record.

18. Declarations of Interest

There were no declarations of interest.

19. Public Questions or Statements

The Chairman noted that further questions had been received from a previous public questioner, in relation to fossil fuel investments, however, the request was for the Chairman and Treasurer to respond to the issues raised and, therefore, the questions would not be submitted to the Committee. The Chairman stated that he would provide a response to the questions accordingly.

20. Pension Board Annual Report

Considered -

The report of the Treasurer providing details of the Annual Report of the North Yorkshire Local Pension Board.

The Chairman of the Pension Board presented the document to the Committee, highlighting that this was the first Annual Report produced by the Board as the body had only been in existence for part of the year for 2015/16, therefore, it was decided to amalgamate the initial work into one annual report up to March 2017.

In the terms of reference for the Board it was requested that an Annual Report was submitted to the Administering Authority, therefore, the report would be considered by the County Council's Executive, before being submitted to full County Council for consideration.

Resolved -

That the Pension Board annual report for 2016/17 be noted.

21. North Yorkshire Pension Fund Final Accounts and Annual Report

Considered -

The report of the Treasurer requesting Members to note the Statement of Final Accounts for the financial year 2016/17 and to approve the Pension Fund Annual Report for 2016/17.

The Treasurer highlighted the changes that had been made to the draft Statement of Accounts, with those having been delegated to him, and the Chairman, at the previous meeting of the Pension Fund Committee. He noted there had been no significant changes and the External Auditors had now signed off the accounts. Details of the changes were set out in the report and it was noted that the Constitution required the County Council's Audit Committee to approve the Final Accounts therefore, the details were submitted to the Pension Fund Committee for information only.

The Pension Fund's Annual Report 2016/17 was attached as an Appendix to the report and was submitted for approval by Members of the Committee. The Treasurer noted that the format of the report had been updated, however, the content remained the same as in previous years and was compliant with LGPS Regulations 2013.

The governance documents, referred to in the report, had been approved at the July meeting of the Pension Fund Committee.

A Member referred to the section relating to members leaving the Scheme and asked whether their pension payments were repaid or held for payment at a later date. In response it was stated that should Scheme members have been paying into the Fund for two years or less their payments would be refunded, otherwise these would be deferred for payments at pension age or transferred to another Pension Fund, on request. The Chairman noted that there were a large number of deferred pensions within the Scheme and highlighted that transfers in/out were a major issue for the Administration Team.

Resolved -

(i) That the Statement of Final Accounts for 2016/17 be noted; and

(ii) That the Pension Fund Annual Report for 2016/17 be approved.

22. Implementation of the Markets in Financial Instruments Directive (MIFID II)

Considered -

The Report of the Treasurer outlining the impact of the implementation of the Markets in Financial Instrument Directive 2014/65 ("MiFID II") and in particular the risk to the administering authority of becoming a retail client on 3rd January 2018.

The Treasurer explained the context to the requirement for North Yorkshire Pension Fund, and all other local authority Pension Funds, to be categorised as “retail clients” (unless opted up by firms to an elective professional client’ status), whereas previously they were classified as ‘per se professional’ clients.

The potential impact on the Fund was explained and would mean that all financial services firms would have to treat local authorities the same way as they did non-professional individuals and small businesses. There would be an impact on the Fund in terms of additional work, and money, required to implement the Directive. There would also be an impact in terms of the limiting of the range of assets available to implement an effective, diversified investment strategy as many institutions were not authorised to deal with retail clients. Certain asset classes would also become unavailable to LGPS fund portfolios. Details were set out in an appendix to the report.

The Treasurer outlined the process required to elect to be treated as professional clients (opt-up): the quantitative and qualitative test, and noted that the SAB, LGA, DCLG and IA had successfully lobbied the FCA to ensure the test better met the unique situation of local authorities. Details of the new tests were set out in an appendix to the report. The election to professional status had to be completed with all financial institutions prior to the change of status on 3rd January 2018. A standard opt-up process had been developed to enable a consistent approach to assessment. Appendices to the report detailed the process and provided appropriate templates.

The Treasurer detailed how applications could be made in respect of either all of the services offered by the institution or a particular service only. It was recommended that officers determine the most appropriate basis of the application, either via full or single service. Authorities were not required to renew elections on a regular basis but would be required to review the information provided in the opt-up process and notify all institutions of any changes in circumstances which could affect their status.

In terms of LGPS pools these were professional investors in their own right so would not need to opt up with the external institutions they use. Local authorities would however need to opt up with their LGPS pool in order to access the full range of services and sub-funds on offer. In some circumstances the pool could use ‘safe harbour’ provisions resulting from local authorities continuing to be named as professional investors in both the Financial Promotion Order (the “FPO”) or in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order (the “PCISO”). These provisions would enable the promotion and potential sale of units in fund structures to local authorities as retail investors.

Elections to professional status would be needed for every financial institution that the authority used outside of the pool, both existing and new, together with a continuing review of all elections. If all new purchases were made via fund structures within the pool then no new elections will be required, only an ongoing review of the elections made with the pool and any legacy external institutions, the number of which would reduce as assets were liquidated and cash transferred.

The Treasurer stated that to continue to effectively implement the authority’s investment strategy after 3rd January 2018, applications for election for the Fund to be treated as a professional client should be submitted to all financial institutions, with whom the authority had an existing or potential relationship, in relation to the investment of the pension fund and the process should commence as soon as possible. Authority should be delegated to the Treasurer to make applications on the authority’s behalf and to determine the nature of the application on either full or single service basis. Updates on progress would be submitted to future meetings.

Discussion of the report by Members resulted in the following issues and points being raised:-

- Concerns were raised that the Directive overcomplicated the current situation, and did not improve the current situation. The Treasurer sympathised with the view expressed but emphasised that the Fund had to comply with Directive to ensure the investment strategy could continue to be implemented.
- It was noted that the Directive had to be in place by 3rd January 2018, and that the process had commenced on 3rd July 2017. The timescales for implementation were difficult, but were expected to be met.
- It was noted that the Directive would have still been implemented whether pooling had taken place or not, and plans were in place for this prior to the pooling requirements being developed.
- It was recognised that the issue was complex and the Treasurer re-emphasised the implications of not ‘opting-up’ ie no access to alternative investments or discussion of fees on existing investments.

RESOLVED:-

(i) that the potential impact on the investment strategy of becoming a retail client, with effect from 3rd January 2018, be noted;

(ii) that the immediate commencement of applications for professional client status, with all relevant institutions, in order to ensure that the Pension Fund can continue to implement an effective investment strategy, be agreed;

(iii) that the Committee acknowledges, and agrees to forgo, the protections available to retail clients as detailed in Appendix 1 to the report, in electing for professional client status; and

(iv) that agreement be given to the delegation of the responsibility to the Treasurer of the Fund to complete the applications and determine the basis of the application as either full or single service.

23. Member and Employer Issues - Administration Report

Considered -

The report of the Treasurer providing Members with information related to the administration of the Fund over the year, to date, and providing an update on key issues and initiatives which impact on the Administration Team. The report provided details of the following:-

- Admission agreements and new academies.
- Membership statistics.
- Performance statistics.
- Annual Benefits Statements.
- Efficiency review.
- GMP reconciliation.
- General Data Protection Regulations (GDPR) 2018.
- Member training.
- Meetings timetable.

It was noted that the report had been slightly altered in relation to previous reports with more visibility given to the impact on the Administration Team.

Members discussed the report and the following issues and points were raised:-

- A Member welcomed the new style of report and suggested that it was very informative.

- Another Member also welcomed the report but considered that it would be appropriate to provide feedback on the new style of reporting once this had been submitted to a number of meetings, allowing an overall impression of how this differed from previously to be developed.

- Noting the trend downwards in active members, it was asked whether there would be sufficient cash, going forward, to meet outgoings. In response it was noted that auto-enrolment for LGPS funds provided some safeguarding in terms of the cash-flow situation and it was considered that, currently, there would be sufficient cash available to the Fund, in terms of payments out, for the foreseeable future. It was noted that of the 12 Funds entering the BCPP pooling arrangements, only two of those were cash-flow positive, including North Yorkshire Pension Fund. It was a situation that would continue to be closely monitored, therefore.

- A Member noted that not all the Annual Benefits' Statements had been issued by the statutory deadline and, noting that the Pensions Regulator had stated that they were to be more robust around such issues, wondered whether consideration had been given to self-reporting this to the Regulator. In response it was noted that there was still outstanding work in relation to this issue and until that had been completed it could not be determined whether the figures published were correct in terms of the issuing of Annual Benefits' Statements. It was suggested, therefore, that it would be premature to self-report to the Regulator until the position had been fully clarified. It was noted, also, that the Administration Team had appropriate plans in place to address the situation. The Member considered that the issue still had to be considered, in case the Regulator did intervene. In relation to this it was stated that a breaches log was being developed, for such matters to be recorded, so full explanations could be provided to the Regulator when necessary. The Member suggested that this was an appropriate course of action in relation to this matter.

- A Member highlighted the details of conferences and seminars provided in the report and suggested that new Members to the Committee would benefit from attending some of these, as he had done during his years of service to the Pension Fund Committee and noted how they provided an excellent networking opportunity with representatives from other Pension Funds. It was stated that Members should contact Amanda Alderson or Gary Bowden if they wished to attend any conference/seminar detailed.

- Reference was made to the non-attendance of Members at the recent training session and it was suggested that, in future, events should be better publicised and reminders provided to Members of when these were taking place.

- Reference was made to the General Data Protection Regulations (GDPR) 2018 and it was asked whether there were sufficient resources in the Administration Team for the volume of work required in complying with these Regulations. In response it was stated that the overarching structure would be provided through North Yorkshire County Council and would assist the Pensions Administration Team in complying with these Regulations.

- Members noted that there had been a substantial increase in the number of admitted bodies within the Fund and it was asked whether this was putting additional pressure on the Administration Team. It was acknowledged that a large amount of work had been created by the number of additional admitted bodies, particularly from the academisation of schools, but some of the burden of the work involved had been undertaken by the County Council's Legal Team, which was assisting the Pensions Administration Team in coping with the additional work. Members raised concerns regarding large numbers of additional admitted bodies coming into the Fund, the potential risk of those failing and the effect that could have on funding levels. It was acknowledged that this area was a potential risk to the Fund, however, it was expected that the Department for Education would be the guarantor for academies, should a failure occur, in terms of arrangements around pension funding. The Treasurer stated that he would clarify this situation with the Department for Education.

Resolved -

That the report, together with the issues raised by Members, be noted.

24. GMP Reconciliation

Considered -

The report of the Treasurer seeking approval to fund a comprehensive project to reconcile Guaranteed Minimum Pension (GMP) values held on the Pension Scheme administration system, Altair, with the values held for NYPF Scheme members on Her Majesty's Revenue and Customs (HMRC) records.

The Treasurer explained how the Local Government Pension Scheme was a defined benefits scheme which was contracted out of the State Earnings Related Pension Scheme (SERPS). From 6 April 2016, the Government had decided that contracting out would be abolished coinciding with the introduction of the new single tier state pension and, as a result, HMRC had provided a one-off service to enable schemes to reconcile the GMP figures they held with those held by the HMRC. The service would cease in December 2018 after five years of operation.

It was essential to reconcile the GMP element recorded on Altair with those held on HMRC systems, to ensure that qualifying pensions coming into payment together with qualifying pensions already in payment were paid at the correct amount, in line with the statutory regulations governing the administration of the LGPS. This would ensure the liabilities of the scheme were represented accurately at each future valuation.

The Treasurer stated that, for a varied number of reasons, there were a large number of discrepancies present in the data held on Altair and HMRC, therefore, before the cessation of the service offered the discrepancies would need to be rectified. He noted that the proposed reconciliation project was likely to identify significantly larger number of overpayments, compared to the number of underpayments, therefore it was important to undertake the project, so that these could be adjusted going forward.

An additional issue related to the Scheme and HMRC not agreeing on which members actually had a GMP and the reconciliation would ensure that the Scheme was paying the correct level of benefit at the correct time and that the liabilities of the Scheme were correctly reported at each valuation.

The Treasurer provided details of the extent of the work involved and noted that this was to be undertaken by an external organisation that specialised in the cleansing, extraction, comparison, and classification of data. He provided details of the financial justification for outsourcing the project and the costs involved. It was noted that the anticipated cost of the project was in the region of £230k with the work lasting for around 12 months. It was expected that the potential savings would be in the region of £1.9m on an ongoing basis, increasing each year in line with annual pension increases.

The following issues and points were raised during Members discussion of the report:-

- It was asked how underpayment/overpayment had occurred when LGPS had been working to a structured formula. An explanation was provided as to how this was occurring and why. An explanation was also provided as to how the discrepancies would continue to grow larger should the reconciliation not take place.

- A Member asked whether North Yorkshire Pension Fund would seek to recover overpayments, or pay out in relation to underpayments. It was explained that the rectification stage would take account of individual anomalies and the Pension Fund Committee would determine how to respond to those. It would not be necessary to impose a reclamation exercise where overpayments had occurred.

- It was clarified that the appropriate procurement procedure had been undertaken for the appointment of the external contractor who would be carrying out this process.

- Clarification was provided as to the extent of the project and the number of pensioners and independent members affected. It was noted that an initial analysis of data had been undertaken to determine the likely extent of the project. That analysis had identified the need to use an external contractor to deal with the project. It was expected that this would enable the reconciliation to be undertaken as efficiently and as effectively as possible.

- It was asked whether the timescales highlighted could be met and, once completed, that there would be no more issues in relation to this. In response it was stated that it was expected that the employment of the data team would enable the timescales to be fulfilled and would eradicate the discrepancies, going forward. It was noted that there would be no further opportunities to reconcile the discrepancies after December 2018. It was also clarified that the firm employed to undertake the project were liable for any issues that arose subsequent to that date.

Resolved -

That the expenditure required to complete the project outlined be approved.

25. Budget and Statistics

Considered -

The report of the Treasurer outlining the following:-

(a) The expenditure/income position to date for 2017/18.

(b) The cash deployment of the Fund.

The Treasurer stated that the cash surplus for the quarter to 30 June 2017 of £37.8m was higher than the forecast by £1.9m. Pensions' payroll expenditure of £19.9m and retirement grant payments of £7.3m were higher than forecast by £0.1m. Contributions income of £64.0m represented a £1.1m positive variance to the budget. Transfer income for the period was £0.7m more than forecast at £2.5m. The GMP reconciliation (as detailed in the previous item) had now been included in the budget.

Details of the cash deployment in 2017/18 were outlined in the report.

Resolved -

That the report be noted.

26. Performance of the Fund's Portfolio for the Quarter ending 30 June 2017

Considered -

The report of the Treasurer providing details of the investment performance of the overall Fund, and of the individual Fund Managers, for the period to 30 June 2017.

The report indicated that the absolute overall return for the quarter (+2.3%) was above the customised benchmark for the Fund (+0.7%) by +1.6%.

The 12 month absolute rolling return was +21.9%, 5.9% above the customised benchmark of +16.0%.

Absolute and relative returns over the rolling years to each of the last four quarter ends were provided by way of comparison.

The report provided details of individual Fund Managers' performance in respect of the following asset classes:-

- ♦ Overseas equities
- ♦ Global equities.
- ♦ UK equities.
- ♦ Fixed income.
- ♦ Property.
- ♦ Diversified growth funds.

Details relating to risk indicators, solvency, rebalancing and proxy voting were also provided.

The Treasurer invited representatives of AON Hewitt, the Fund's investment consultants, to provide an analysis of the performance of the Fund during the quarter to 30 June 2017 and they highlighted the following:-

- ♦ The Fund's investments had again performed very well during the quarter to the end of June 2017.

- ♦ There had been a strong performance in respect of equities, particularly from Baillie Gifford.

- ♦ The potential for interest rate rises, now being mooted worldwide, was having a positive effect on bond yields.

- The Fund was at 105% funding level at the end of June 2017, with a £160m surplus.

- Details of the performances of individual Fund Managers were highlighted and again the strong performance in the equity markets was noted.

- Investments into the private debt alternatives were continuing, with £20m invested by the end of August, moving toward a target of £130m.

- Changes to the portfolio management at Standard Life were outlined, together with some concerns regarding their performance.

- The forthcoming investment workshop would consider issues around the following:

  - currency hedging
  - how to reduce volatility in terms of equity investments
  - how to decrease volatility overall on the investment strategy whilst maintaining the good performance of the Fund's investments.

Members discussed the reports and the following issues and points were raised:-

- When considering disinvestment in equities the need to maintain the stronger performers, for example Baillie Gifford, with consideration given to reducing equities from other Fund Managers. The Investment Consultants acknowledged the issues raised but emphasised the need for the diversified portfolio, noting the strengths and weaknesses in each of the equity managers and their performance, both short term and long term, which were all of benefit to the Fund. It was emphasised that a measured approach to equity investments, to protect the Fund against volatility would be discussed in full at the investment strategy workshop.

- A Member welcomed the new representatives from the Investment Consultant, expressing his disappointment in losing the previous representatives, but stating that he looked forward to working with the new team.

- Issues around the performance of Fidelity and Standard Life were discussed with a brief outline of recent performance provided, however, it was noted that a much more in-depth discussion of Fund Managers' performance would take place at the following day's investment strategy workshop. The Treasurer noted that the discussions at the forthcoming workshop would be utilised to formulate recommendations, to be submitted to the Pension Fund Committee, in terms of moving forward with the investment strategy. A Member noted the current surplus and the recent excellent performance of the Fund's investments and emphasised the need to safeguard the current position wherever possible.

- It was noted that issues relating to the cash-flow position of the Fund and maintaining a positive cash-flow would also be considered at the investment strategy workshop, with a view to maintaining this going forward.

Resolved -

That the investment performance of the Fund for the period ending 30 June 2017 be noted.

27. LGPS Pooling Arrangements

Considered -

The report of the Treasurer updating Members on progress towards the Government's announced proposal to pool the assets of LGPS Funds and allowing the Committee to provide a formal view on Scheme Member representation on the Joint Committee.

The Chairman, also Chairman of the Joint Committee, provided details of the appointment of the non-Executive Chairman of the Board for the Pool and of the forthcoming appointment of the Chief Executive of the Board. He noted that the other appointments, both non-Executive and Executive, were yet to take place, but the recruitment process had commenced.

A Member raised concerns regarding the development of pooling, generally, despite accepting the fact that it had to be undertaken. He considered that an important issue ahead of the pool was asset allocations, with particular regard to the recent excellent performance of the North Yorkshire Pension Fund investments. He considered the lack of opportunity to have direct contact with Fund Managers, going forward, to discuss and debate how investments best suited the Fund would be detrimental. He also considered that the transition phase into the pool was potentially problematic and noted that there still appeared to be a focus on investment in infrastructure projects despite the North Yorkshire Pension Fund having expressed an opinion that it would only invest in the asset class should there be an appropriate project to invest in that which would provide the Fund with suitable returns.

He also raised concerns that the Board for the Pool would not have Local Government Pension Scheme experience unless the recruitment exercise actively sought to address that.

In response to the issues raised the Chairman acknowledged the concerns regarding the lack of Local Government Pension Scheme influence on the Board of the Pool and stated that he had made representations in relation to that. He was hopeful, therefore, that this matter would be addressed and that appropriate appointments would be made, going forward.

In respect of to the issues raised in relation to Fund Managers the Chairman noted that the Pension Fund Committee would continue to have an influence with regards to the investments made on behalf of North Yorkshire Pension Fund, however, the issue of direct contact with Fund Managers could not be controlled as North Yorkshire Pension Fund had to operate within the parameters of the pooling arrangements.

In terms of the transition process the Chairman outlined an initial timetable commencing in July 2018. He noted that full details would be presented to the Pension Fund Committee in relation to this and, at this stage, the timetable was not agreed and would be subject to alteration. He noted that further consideration was to be given to the transition process at the next meeting of the Joint Committee for the pool and those discussions would then be subject to consideration at a forthcoming meeting of the Pension Fund Committee. It was emphasised that transition into the pool from NYPF would be undertaken to best suit the needs of the North Yorkshire Pension Fund.

In respect of infrastructure the Treasurer emphasised that the Pension Fund Committee would determine asset allocation and investments on behalf of the North Yorkshire Pension Fund and, therefore, there would be no necessity to invest in infrastructure should that not be considered appropriate by the Committee. He also emphasised that there may be appropriate infrastructure projects that provided a suitable return and consideration would be given to these, if it was felt appropriate.

A Member asked whether some of the existing investments would be able to be transferred directly across to the pool, without having to disinvest and re-invest, thereby avoiding transition costs. In response it was noted that there would be more than 40 sub-funds available through the pool and it was hoped that some of these would allow the continuance of existing investments by the North Yorkshire Pension Fund, which could assist in reducing transition costs.

The Chairman outlined the difficulties being faced by the financial sector whereas previously they had 89 Funds to offer their services to and this was being reduced to eight pools of Funds, greatly reducing their opportunities to represent those Funds.

A Member emphasised the need to have appropriate systems and infrastructure in place, and fully tested, to ensure that BCPP was operating appropriately before the transition timetable commenced.

The Treasurer noted that the Section 151 Officers of the Funds had agreed to contact both the Chair and Vice-Chair of the Joint Committee and the non-Executive Chairman of the Board to outline their concerns regarding, potentially, the lack of local government experience and knowledge of the BCPP Board.

A Member emphasised the need for BCPP to perform strongly on investments to ensure that the recent performance of North Yorkshire Pension Fund was maintained.

The Chairman noted that the Pension Fund Committee had been requested to provide a formal view on Scheme member representation on the Pool's Joint Committee.

Discussion of this issue by Members raised the following issues and points:-

- ♦ It would be difficult to identify a single representative that could address Scheme member issues for all of the 12 Funds.
- ♦ It would be difficult to provide an appropriate report back mechanism due to the wide scale nature of the Pool, geographically, politically and demographically.
- ♦ Members considered that it was difficult to see how an appointment of a Scheme member representative on the Joint Committee would work effectively.
- ♦ It was suggested that, as the meetings would be public, Scheme member representatives would be able to attend, could ask questions at meetings and could report back accordingly, without being formally appointed to the Joint Committee.

Resolved -

(i) That the update on progress towards the proposal to pool the assets of LGPS Funds, and the issues raised by Members in relation to that, be noted; and

(ii) That no Scheme member representative should be appointed, formally, to the Joint Committee.

28. Pension Board - Draft Minutes of the Meeting held on 20 July 2017

Considered -

The draft Minutes of the Pension Board held on 20 July 2017.

Resolved -

That the draft Minutes be noted.

Members were invited to an investment strategy workshop taking place at 10 am on Friday 15 September 2017.

The meeting concluded at 12.30 pm

SL/JR