# TEESSIDE PENSION BOARD

A meeting of the Teesside Pension Board was held on 7 November 2016.

**PRESENT:** Mr C Monson (Chair), Mr G Whitehouse (Deputy Chair), Mr G Clyburn, Mrs J Cook, Councillor N J Walker and Councillor B Woodhouse

**ALSO IN ATTENDANCE:** S Kenny - Ernst Young - Auditors

**OFFICERS:** J Bromiley - Strategic Director, Finance, Governance and Support, P Campbell - Head of Investments and Treasury Management, B Carr - Principal Democratic Services Officer and G Hall Scheme Co-ordinator.

**APOLOGIES FOR ABSENCE:** None.

**DECLARATIONS OF INTERESTS**

| Name of Member | Type of Interest | Item/Nature of Interest |
|---|---|---|
| Mr G Clyburn | Non Pecuniary | Member of Teesside Pension Fund |
| Mrs J Cook | Non Pecuniary | Member of Teesside Pension Fund |
| Mr C Monson | Non Pecuniary | Member of Teesside Pension Fund |
| Mr G Whitehouse | Non Pecuniary | Member of Teesside Pension Fund |
| Councillor B Woodhouse | Non Pecuniary | Member of Teesside Pension Fund |

1 **MINUTES - TEESSIDE PENSION BOARD - 11 JULY AND 19 SEPTEMBER 2016**

The minutes of the Teesside Pension Board held on 11 July 2016 and 19 September 2016 were taken as read and approved as a correct record subject to the following:

11 July 2016 - Move Exclusion Clause to before the Reform of LGPS Investments - Final Submission Agenda Item.

11 July 2016 and 19 September 2016 remove reference to Councillors under '**Present'.**

**NOTED**

2 **MINUTES - TEESSIDE PENSION FUND AND INVESTMENT PANEL - 29 JUNE 2016**

The Strategic Director of Finance, Governance and Support submitted a copy of the minutes of the Teesside Pension Fund and Investment Panel held on 29 June 2016 for information.

**AGREED** that the minutes of the Teesside Pension Fund and Investment Panel held on 29 June 2016 be noted.

3 **INVESTMENT PANEL MEMBER TRAINING REPORT - COUNCILLOR N J WALKER**

Councillor Walker advised the Board that a report had been submitted to the Teesside Pension Fund and Investment Panel recommending that the Introductory Training, which was currently mandatory for Middlesbrough Council Members of the Teesside Pension Fund and Investment Panel (TPFIP), was made mandatory for all Members of the TPFIP and any substitutes.

The report had also recommended that Introductory Training should be offered to the Trade Union representatives sitting on the TPFIP, on a voluntary basis. Members of the TPFIP would also be required to complete an assessment form, following completion of the

Introductory Training, to check the required level of knowledge and competence had been achieved, in order to comply with the Myners Principles.

The Board was advised that it was highlighted at the meeting that the requirement for training was not a reflection on any individual. The TPFIP had agreed the report and the training would be implemented from the next Municipal Year. All of the training would need to be logged and monitored.

Reference was made to the new CIPFA guidance in relation to Members sitting on decision making committees and the requirement for them to have the appropriate level of training and knowledge to make decisions.

**AGREED** as follows:-

1. That the Introductory Training, which was currently mandatory for Middlesbrough Council Members of the Teesside Pension Fund and Investment Panel (TPFIP), be made mandatory for all Members of the TPFIP and any substitutes from the next Municipal Year.

2. That the Introductory Training be offered to the Trade Union representatives sitting on the TPFIP, on a voluntary basis.

3. That an assessment form be completed, following completion of the Introductory Training, to check the required level of knowledge and competence had been achieved and that any training be logged and monitored.

4 **EXTERNAL AUDIT REPORT 2015/2016**

The External Auditor Manager from Ernst Young was in attendance at the meeting to inform the Board of the findings and observations following a review of the Annual Report and Financial Statements for 2015/2016.

External Audit issued an unqualified opinion in respect of Annual Report and Financial Statements included within Middlesbrough Council's Statement of Accounts.

The Board was referred to the Executive Summary on Page 1 and 2 and it was highlighted that there had been no audit differences identified in relation to the numbers reported that required to be reported to the Board. Following completion of the auditor's planning and receipt of the draft financial statements the auditor had calculated a materiality level of £31.3m which was based on the Fund's total net assets for the year. Using EY's methodology, a threshold for reporting audit differences of £1.56m was calculated.

Following the audit planning, the auditors had changed their assessment of the following significant risks:

- The risk of fraud in revenue recognition - EY had determined that the risk of fraud arising from revenue recognition could be rebutted on the basis that there was little incentive and limited opportunity to manipulate the significant revenue streams.
- EY had removed the valuation of private equity funds as a significant risk on the grounds that the valuation was trivial to the net assets of the Fund and therefore there was a minimal likelihood of a material error.

Following the audit planning, EY had identified the implementation of the new accounting system (Agresso) as a significant risk because of the large migration of data onto the new system. Following sample testing of the migration of data, no issues were identified. It was highlighted that officers of the Fund had little involvement in the implementation of the new finance system as it was led by Agresso, and as a consequence the Fund only had limited knowledge of the controls used to ensure the successful migration of data between systems.

In terms of Modification of Opinion, EY had reviewed the final Annual Report and were satisfied that it complied with the necessary regulations and best practice.

The Board was advised that the list of active, pensioner and deferred members was provided to the auditor at the year-end date and that a list of member movements during the year for each category was not available. From an auditor's perspective, being able to access a list of member movements was useful for reassurance in respect of identifying if benefits were included in the accounts for the right period. It would also enable an overall sense check to support the movement of account balances during the year to be provided. The auditor recommended that the Council give consideration to whether it should introduce a full listing of movements that would assist in reconciliation between the categories in the future. A member of the Board queried whether this would represent a risk if the Council did not provide a full list of movements. The auditor confirmed that other controls were in place to mitigate the risk.

In terms of the risks of management override, following the appropriate testing, EY did not have any matters to report. The Board was advised that the auditor had not identified any significant deficiencies in the design of an internal control that might result in a material misstatement in the Fund's financial statements of which the Fund were not aware.

During the course of the audit, the auditors were asked to comment on how the Governance of the Fund compared to other large pension schemes and a list of high level observations and recommendations was set out at Page 9 and 10 of the Financial Statements audit.

The auditor highlighted the following recommendations:

- Documenting the role of the Board - that consideration was given as a matter of priority to the appointment of an external consultant to advise on governance, administration and compliance to ensure that best practice was adopted and improvements made where necessary; and an external investment advisor to help support the Board in its ability to scrutinise effectively and to advise on operational responsibilities in respect of managing risk effectively etc.;
- that a Training Log be introduced in respect of all Board and Panel Members which should be personalised for each member to address any gaps in knowledge;
- that the Board have oversight of the Fund's Investment portfolio;
- that the Panel updates the status of current levels of compliance with the Myners Principles which the Board should then review and take advice as necessary and identify any gaps and actions to address those gaps;
- that the Risk Register should be considered and updated on a regular basis by the Panel.

A copy of the Management representation letter was attached at Appendix D.

In response to a query with regard to the role of the Board, the auditor advised that the way in which the auditor viewed the role of the Board was to carry out scrutiny of the TPFIP. The Board could look at what functions the Panel was currently doing to ensure that there was no duplication with the work of the Board.

The Strategic Director for Finance, Governance and Support advised that he fully supported the findings of the auditor. He stated that there was a requirement to look at the Governance of the Fund as a whole to examine how the TPFIP and the Board operated to define roles. Work was already ongoing in respect of this issue and a report would be brought back to the Board at a later date.

The work involved looking at the membership of TPFIP to ascertain if there needed to be a more equal split between members of the different local authorities. As part of the review, consideration would need to be taken in respect of whether any revision to the governance arrangements would work if the Fund joined a pool. The constitution would also need to be changed to reflect any changes.

A Working Party would be established which would consist of members of the TPFIP, the Board and external expertise which would need to be procured to advise on governance and operational issues. In terms of the timescale, the Board was advised that it would be preferable if the Terms of Reference of the Working Group could be agreed as soon as possible in order for the review to commence. A member suggested that the Chair and the

Deputy Chair be appointed as the Board's representatives on the Working Party.

**AGREED** as follows:

1. That the External Audit Report (Appendix A), as presented by EY, be noted.

2. That a Working Party be established to review and discuss the Governance Observations and Recommendations included at page 8 - 10 of the external audit report 2015/2016.

3. That the Draft Terms of Reference in respect of the above Working Party be emailed to all Members of the Board and submitted to the TPFIP for consideration.

5 **GOVERNMENT ACTUARY'S DEPARTMENT - SECTION 13 DRY RUN REPORT**

The Strategic Director of Finance, Governance and Support submitted a report to inform Members of the Teesside Pension Board (the Board) of the Government Actuary Department (GAD) LGPS Section 13 Dry Run Report.

The Chair advised that he had informed the Board at the meeting held on 13 July 2016, that the Government Actuary Department (GAD) LGPS Section 13 Dry Run Report was due to be completed, following information received at a Local Pension Boards conference that he had attended on 29 June 2016.

It was highlighted that Section 13 would apply for the first time to the 2016 round of LGPS (England & Wales) separate fund valuations. The purpose of the dry run was to allow the GAD to refine their approach and help administering authorities prepare for the first 2016 report. The 2016 report was expected to be available by late 2018 or early 2019.

The Board was advised that a meeting had been held in Durham in September 2016 and a representative from the Government Actuary Department had presented the outcome of the Section 13 Dry Run report. A copy of the Section 13 report (which was based on the 2013 local valuations), was attached at Appendix A to the report.

The report provided an opinion on the following:

- Compliance - whether the fund's valuation was in accordance with the scheme regulations;
- Consistency - whether the fund's valuation had been carried out in a way which was not inconsistent with the other fund valuations within the LGPS;
- Solvency - whether the rate of employer contributions was set at an appropriate level to ensure the solvency of the pension fund; and
- Long Term cost efficiency - whether the rate of employer contributions was set at an appropriate level to ensure the long-term cost-efficiency of the scheme, so far as relating to the pension fund.

The Government Actuary assessed Funds under a number of measures using A RAG rating system. Each Fund's score under each measure was colour coded, where:

**Red**: indicated a potentially material issue that could contribute to a recommendation for remedial action in order to ensure solvency;

**Amber**: was used to highlight a possible risk to sponsoring employers; and

**Green**: indicated that there were no material issues that could contribute to a recommendation for remedial action in order to ensure solvency.

The Teesside Pension Fund's results were shown on page 45 of the Dry Run Report. The results showed only one Amber rating in respect of Asset Shock. Asset shock measured the change in average employer contribution rates as a percentage of payroll after a 15% fall in value of return-seeking assets (equities, property and alternative investments).

The Public Service Pension Act 2013 stated that: 'Long-term cost-efficiency implied that the rate must not be set at a level that gives rise to additional costs. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the time.'

The GAD had concluded that, overall, the rate of employer contributions were set at an appropriate level to ensure long term cost efficiency if the rate of employer contributions was sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

Chart 4.6, which was included at page 38 of the Appendices to the Dry Run Report, showed details of the Standardising local valuation results.

Reference was made to Page 41 of the report in respect of 'Solvency measures - the risks already present', particularly in relation to the proportion of scheme employers without tax raising powers or without statutory-backing e.g. employers outsourcing work to partners (e.g. Kier), where the employees were a member of the LGPS. The report discussed strengthening employer covenants and the Board was advised that this could be looked at as part of the actuarial assumptions.

The report identified the following risks already present:

- Funding level on the SAB standard basis;
- The extent to which the fund continued to be open to new members. If the fund was closed to new members or was highly mature, it would focus on the ability to meet additional cash contributions;
- The ability of the fund to meet benefits due (without constraining investment policy); and
- The ability of tax raising authorities to meet employer contributions.

The emerging risks were identified as follows:

- The cost risks posed by changes in the value of the scheme liabilities (to the extent that these were not matched by changes to the scheme assets);
- The cost risks posed by changes to the value of scheme assets (to the extent that these were not matched by changes to the scheme liabilities);
- The proportion of scheme employers without tax raising powers or without statutory backing; and
- How the risks above compared with the pensionable payroll of scheme employers, and the wider income of sponsoring employers as a whole.

Reference was made to Chart H2 which indicated that TPF required a return of 4.8% investment return to achieve full funding in 20 years' time. The Head of Investments and Treasury Management advised that the Fund had a customised benchmark in return seeking assets of 85% and 15% in protection assets. This rate was equivalent to the discount rate used in the valuation and it was predicted that there was a 75% probability that the Fund would achieve this.

The Chair commented that most of the figures in respect of TPF were positive in comparison to other pension Funds and the Fund appeared to have virtually the lowest employer contribution rate.

Reference was made to the performance of the Fund over the previous few years and it was commented that the performance had not been particularly good. The Board was advised that the fact that the Fund was fully funded at the last valuation, showed that it had benefitted from some long-term good decisions. The performance figures used for the dry run were from the period 31 December 2012 to 31 March 2013.

**AGREED** that the report be noted.

6 **LGPS INVESTMENT REFORM (POOLING ASSETS) - UPDATE**

The Strategic Director of Finance, Governance and Support submitted a report to follow up the reports on LGPS Investment Reform presented at previous meetings and inform Members of the Teesside Pension Board (the Board) of the latest developments in setting up the new Pool (BCPP - Border to Coast Pension Partnership).

The Board was advised that the following costs had been identified:

- To set up BCPP, particularly if it was required to be regulated by the Financial Conduct Authority (FCA) as anticipated;
- To transfer the Fund's assets to the chosen Pool; and
- Once up and running, there would be management expenses for managing the new Pool shared by the Pool's partners.

A detailed estimate of the implementation costs was set out in the BCPP proposal (page 38). Within this estimate, a worst case scenario cost to set up BCPP of approx. £4.2 million had been calculated. This estimate was provided by Deloitte as part of their cost benefit analysis for BCPP's final submission. This cost would be shared equally among the 12 shareholders/partners of BCPP, which equated to £350,000 each.

It was anticipated that there would be potential savings and other benefits:

- If an Authorised Contractual Scheme (ACS) structure was used, there were further savings to withholding tax on dividends received from French and Swedish equity investments;
- The scale of BCPP would potentially reduce the management costs of externally managed funds, including infrastructure related investments, to a lower cost that would make these funds more attractive investments than they were currently; and
- Access to a larger pool of investment professionals than was currently available to the Fund should improve resilience and provide a greater range of investment asset types available to the Fund.

The detailed pooling proposal was presented to the Teesside Pension Fund and Investment Panel at the meeting held on 29 June 2016. The Panel agreed this version of the proposal and delegated authority to the Chair to review the final version and sign it on behalf of the Fund. The final BCPP proposal was submitted to DCLG on 15 July 2016 from further consideration. Representatives from the DCLG, HM Treasury and independent advisors met on 8 September 2016 to consider BCPPs submission.

Although no further expenditure had been committed until after the DCLG had agreed the proposal and given the go ahead for the formation of BCPP, the proposed timetable, (attached at Appendix A to the report), was very tight so preparation work had already commenced with meetings with potential suppliers of legal advice, finance/tax advice, FCA registration support and Heads of Legal from each administering authority.

The TPFIP had agreed to a revised budget of £350,000 as the share of cost appropriate for Teesside, which could only be spent once approval of the BCPP submission was received from the DCLG.

A Member Steering Group meeting had been arranged for 30 September 2016. At this meeting it had been agreed to set up a detailed project plan, create three Member sub groups who would report back to the main Member Steering Group, and begin preparation work in the following areas:

1. Operating Model - Asset servicing, ICT systems sourcing and implementation, FCA compliance, asset structuring, etc. e.g. will the pool have UK equity and how it would be measured and would the Fund be externally/internally managed etc. The Pool would need to consider whether there was adequate measures in place for home working and whether the IT systems/equipment were FCA approved.

2. People - Setting remuneration packages for senior executives, TUPE transfer of existing

staff, recruitment of senior executives & staff, and securing suitable premises. The key staff would include a Chief Executive Officer, A Chief Operating Officer, a Chief Investment Officer, a Compliance Officer and a Risk Officer. Different arrangements would be in place for Front/Back office staff e.g. automating, outsourcing and the possible relocation of staff.

3. Governance and Monitoring - Co-ordinating final approvals to approve the creation of the Joint Committee, a Shelf Company and final commitment by each Partner Fund to the acquisition of an equal voting shareholding in BCPP.

The next Member Steering Group meeting was scheduled for 18 November 2016. Until the outcome of the meeting was known, work in respect of tenders and other documentation to assist in the set up was ongoing

A meeting with the Minister had been arranged for 16 November 2016 and it was hoped that this meeting would provide clarification in respect of the proposed timetable. The Chair commented that it would be useful to see the notes of the meeting held with the Minister on 16 November 2016.

It was suggested that even if the pooling arrangements failed to go ahead, there may be some benefits in discussing the possibility of establishing collaborative arrangements in respect of future investments.

The Head of Investments and Treasury Management advised that an exercise had been carried out in respect of passive arrangements and fees were negotiated downwards across Pool Members which resulted in one of the Pool Members achieving savings of hundreds of thousands of pounds. The Board was advised that the price of alternative investments were also reducing and Fund Providers were introducing specific fees for LGPS clients.

**AGREED** as follows:

1. That the report be noted.

2. That Board Members be updated in respect of the outcome of the BCPP submission from the DCLG, and the project plan and progress at future meetings.