Lancashire County Council

Pension Fund Committee

Thursday, 27th March, 2014 at 10.00 am in Cabinet Room 'C' - County Hall, Preston

Agenda

Part 1 (Open to Press and Public)

No.	Item	
1.	**Apologies**	
2.	**Disclosure of Pecuniary and Non-Pecuniary Interests** Members are asked to consider any Pecuniary and Non-Pecuniary Interests they may have to disclose to the meeting in relation to matters under consideration on the Agenda.	
3.	**Minutes of the Meeting held on 29 November 2013** To be confirmed, and signed by the chair.	(Pages 1 - 8)
4.	**Urgent Business** An item of urgent business may only be considered under this heading where, by reason of special circumstances to be recorded in the Minutes, the Chair of the meeting is of the opinion that the item should be considered at the meeting as a matter of urgency. Wherever possible, the Chief Executive should be given advance warning of any Member's intention to raise a matter under this heading.	
5.	**Date of Next Meeting** The next meeting of the Committee will be held on Friday 6 June 2014 at 10.00am at County Hall, Preston.	

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6. **Exclusion of Press and Public**

The Committee is asked to consider whether, under Section 100A(4) of the Local Government Act, 1972, it considers that the public should be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the appropriate paragraph of Part 1 of Schedule 12A to the Local Government Act, 1972, as indicated against the heading to the item.

Part II (Not open to Press and Public)

(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

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(Not for Publication – Exempt information as defined in Paragraphs 3 and 5 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

Part I (Open to Press and Public)

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Lancashire County Council

Pension Fund Committee

Minutes of the Meeting held on Friday, 29th November, 2013 at 10.45 am in Cabinet Room 'D' - The Henry Bolingbroke Room, County Hall, Preston

Present:

County Councillor Terry Burns (Chair)

County Councillors

L Beavers	J Oakes
D Borrow	M Parkinson
M Brindle	K Sedgewick
G Dowding	D Westley
R Newman-Thompson	B Yates

Co-opted members

Councillor Ian Grant, (Lancashire Leaders' Group representative)
Bob Harvey, (Trade Union representative)
Councillor Mark Smith, (Blackpool Council representative)

Eric Lambert and Noel Mills, Independent Advisers to the Pension Fund were also present.

John Livesey, Mercer (Fund Actuary) also attended the meeting.

The Committee was informed that the Pension Fund had just received a special commendation in the Funds Europe Awards 2013. Members welcomed the news that the Fund had won the 'European Institutional Investor of the Year' award.

1. Apologies

Apologies for absence were received from County Councillor P White, Councillor D Walsh, Councillor P Leadbetter and Mr R Whittle.

2. Disclosure of Pecuniary and Non-Pecuniary Interests

None.

3. Minutes of the Meeting held on 6 September 2013

The Minutes of the Meeting held on 6 September 2013 were presented.

It was noted that the attendance of Eric Lambert and Noel Mills, Independent Advisers, had been omitted from the Minutes. It was also noted that County Councillor Sedgewick's apologies had not been recorded in the Minutes.

Resolved: That, subject to the above mentioned amendments, the Minutes of the meeting held on 6 September 2013 be confirmed and signed by the chair.

4. Exclusion of Press and Public

Resolved: That the press and members of the public be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the paragraph of Part 1 of schedule 12A to the Local Government Act, 1972, indicated against the heading to the item. It was considered that in all the circumstances the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

5. Investment Performance Report

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee considered a report on the performance of the Fund as at 30 September 2013, focussing on the key areas of:

- the funding position;
- cash flow;
- fund investment performance;
- management performance;
- investment allocations; and
- risk management of the Fund including credit, liquidity, investment and operational risks.

Resolved: That the report be noted.

6. Investment Panel Report

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee received a report from the Investment Panel setting out the work of the Panel at its meetings held on 6 September and 28/29 October 2013. The Committee's attention was specifically drawn to the following key areas:

- The Investment Context in which the Fund was operating
- Credit Investments for consideration
- Infrastructure and Private Equity investments for consideration
- Securities Lending Mandate changes
- Management of outstanding commitments
- Review of Global Equity Managers

The Committee particularly welcomed the results of the global equities re-allocation which showed a strong overall performance.

Resolved: That the report be noted.

The Committee then returned to the remaining Part I agenda items.

7. Actuarial Valuation of the Lancashire County Pension Fund 2013

The Committee considered the results of the 2013 Actuarial Valuation of the Lancashire County Pension Fund.

The triennial Valuation of the assets and liabilities of the Lancashire County Pension Fund as at 31 March 2013 had been carried out by the Fund Actuary, Mercer. John Livesey from Mercer attended the meeting to present the results of the Valuation.

The overall funding level based on the various updated assumptions was around 78% as at the 31 March 2013, compared to 80% at 31March 2010. The overall deficit on the Fund had increased from £0.993bn to £1.377bn. The Committee noted that the movement in the cash value of the deficit had been due to factors which could not be influenced by either the Fund or employers. However, those factors which could be influenced had moved favourably.

It was reported that since 31 March 2013, net yields had risen by around 0.4% thus reducing liability values. This meant that, as at 31 August 2013, the revised overall funding level based on the various updated assumptions was 83% and the overall deficit of the Fund had reduced from £1.377bn to £1.039bn.

Following the Valuation the Committee needed to determine the way in which the Fund would achieve both the bridging of the deficit within the Fund and a sustainable contribution plan for employers. Proposals in relation to this were presented to the Committee at Appendix 'A'.

If agreed with stakeholders following consultation these proposals would form the core of the Funding Strategy Statement which the Fund was required to produce after each valuation.

A further report on the outcome of the consultations with employers would be presented to the Committee during the first quarter of the New Year alongside the issuing by the Actuary of the final rates and adjustments certificate.

The results of the Valuation, including amendments to individual employer contribution rates, would be effective from 1 April 2014.

Resolved:

(i) That the results of the 2013 actuarial valuation of the Lancashire County Pension Fund be noted.

(ii) That the measures in relation to the setting of contribution rates as set out at Appendix 'A' be approved for consultation with stakeholders as part of the preparation of the Funding Strategy Statement.

8. Pension Fund Training Plan 2013-15

The Committee considered a report in relation to the adoption of an annual training plan for officers and members of the Committee.

The purpose of the training plan was to provide officers and members with regular sessions that would contribute to their level of skills and knowledge, and thus ensure that the Fund was compliant with legislative and other pension scheme governance requirements including the CIPFA Knowledge and Skills Framework.

Details of a proposed training plan were presented at Appendix ‘A’. It was noted that the proposed training would follow a self assessment exercise to identify any knowledge gap. Training would comprise a combination of internally developed training sessions, updates from officers and independent advisers, external events and self directed learning.

It was suggested that training should be open to a small number of non-committee members from each political group. This would enable suitably informed and skilled members to fill any vacancies on the committee.

It was agreed that members needed to be committed towards developing their knowledge and skills. Also it was important to ensure that training was undertaken by a cohort of members rather than just a few individuals. A number of suggestions to raise members’ knowledge and skills were suggested. These ranged from the delivery of basic training to more focussed sessions on issues of national pensions related interests including consultation exercises. It was felt that committee reports could also be used as a means to train members and officers agreed to take that on board during the drafting of future reports.

Resolved:

(i) That the proposed Pension Fund Training Plan including the external event approval process as set out at Appendix ‘A’ be approved.

(ii) That all members of the Committee be committed to undertaking appropriate pension fund training to enable the Committee to meet legislative and other governance requirements including the CIPFA Knowledge and Skills Framework.

(iii) That training be made available to non-members of the committee and that the political groups be asked to nominate members to be invited to future training events.

9. Shareholder Voting, Engagement, and Fiduciary Duty

The Committee considered a comprehensive report on the Fund's shareholder voting arrangements and activity, and engagement activity for the period 1 July to 30 September 2013.

The Committee was informed that Pensions and Investment Research Consultants Ltd (PIRC) act as the Fund's proxy and cast the Fund's votes on its investments at company shareholder meetings. PIRC were instructed to vote in accordance with their guidelines unless the Fund instructed otherwise.

It was noted that the Fund had voted on 2,866 occasions during this period and had opposed or abstained in 29% of votes.

Officers agreed to review the information provided in the PIRC report with a view to future reports being adapted to provide greater context and relevance to the Fund and its investments.

The Committee’s attention was drawn to the potential class actions in relation to companies in which the Lancashire Pension Fund owned or had owned shares. It was noted that the Fund was keeping a watching brief over developments in relation to Royal Bank of Scotland in relation to alleged actions that, it is argued, caused investors to suffer losses relating to a subsequent Rights Issue on 30 April 2008. The Fund would need to determine its position prior to the deadline for filing a claim which remained April 2014.

The Committee’s attention was also drawn to recent developments relating to fiduciary duties, much of which had arisen from many authorities taking on responsibility for Public Health from April 2013. It was noted that the Committee had in March 2013 considered the question of whether a conflict arose between the County Council’s imminent public health responsibilities and the Fund’s responsibilities regarding fiduciary duty. The Lancashire Pension Fund’s position was similar to that of the Norfolk Pension Fund e.g. to maintain a policy of voting and engagement with companies whose shares were held.

Members were informed in March that in order to meet its fiduciary duties, the Pension Fund could not unilaterally decide to divest from an individual investment type without regard to the overall objectives of the Fund, or without taking appropriate professional advice including risk and return considerations. A decision to exclude particular investments on ethical grounds and thus affect potential return could be subject to legal challenge. Securing a decent financial return in order to meet future commitments to beneficiaries was the primary objective of a pension fund.

The Committee was informed that since then, work across the LGPS had been on-going in relation to this issue. In October 2013, a sub-committee of the newly created LGPS Shadow Advisory Board considered the issue and decided upon a number of actions:

- The approach taken by Norfolk Pension Fund should be circulated to LGPS Funds as the basis of interim information;
- Counsel's opinion should be sought on the legal status of LGPS funds with regards to fiduciary duty and the limit of broader ethical considerations.

Subsequently the Law Commission had issued a consultation paper on fiduciary duty as it applied throughout the investment chain with a closing date of 22 January 2014.

Following a discussion around the issue of ethical investment and the Fund's fiduciary duty, the Committee welcomed the prospect of greater clarity over fiduciary duty that the recent developments would provide and it was agreed that the Fund would review the position when the outcome of the Law Commission's review was published.

Resolved:

(i) That the report be noted.

(ii) That the Law Commission's review of fiduciary duty be welcomed and that the position with regard to ethical investment and returns be reviewed when the findings of the Law Commission are published.

10. Statement of Investment Principles

The Committee considered a report on a review of the Fund's Statement of Investment Principles (SIP) which had been prompted by the Secretary of State for Communities and Local Government issuing a Statutory Instrument which increased the maximum proportion of a local government pension fund which could be invested in contributions to partnerships from 15 % to 30%.

The Fund's SIP document had been revised to incorporate the greater investment flexibility provided by the Secretary of State and a copy of the revised document was presented at Appendix 'A'.

Resolved: That the updated Statement of Investment Principles, as set out at Appendix 'A', be approved.

11. External Audit report

The Committee considered the Audit Findings Report which set out the findings of the external auditor following their audit of the Pension Fund Accounts for 2012/13.

It was noted that the report had been presented to the Council's Audit Committee on 30 September 2013 and that the external auditor had provided an unqualified audit opinion on the pension fund accounts following that meeting.

Resolved:

That the external Audit report following the audit of the County Pension Fund Accounts for 2012/13 be noted.

12. Urgent Business

None.

13. Date of Next Meeting

It was noted that the next meeting of the Committee would be held on Thursday 27 March 2014 at 10.00 a.m. at County Hall, Preston.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

(NOT FOR PUBLICATION: By virtue of paragraph(s) 3 of Part 1 of Schedule 12A of the Local Government Act 1972. It is considered that all the circumstances of the case the public interest in maintaining the exemption outweighs the public interest in disclosing the information)

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Document is Restricted

Pension Fund Committee
Meeting to be held on 27 March 2014

Electoral Division affected: All

Report of the Pension Fund Administration Sub-Committee
(Appendix 'A' refers)

Contact for further information:
Chris Mather, (01772) 533559, Office of the Chief Executive,
Chris.mather@lancashire.gov.uk

Executive Summary

The Pension Fund Administration Sub-Committee met on 12 March 2014. A copy of the minutes of the meeting is attached at Appendix 'A'.

Recommendation

The Committee is asked to note the minutes of the Pension Fund Administration Sub-Committee meeting held on 12 March 2014.

Background and Advice

The Pension Fund Administration Sub-Committee met on 12 March 2014 to consider reports on the following:

- Public Sector Pension Reform – Changes to the Local Government Pension Scheme as from 1 April 2014
- The Payment of Death Grants
- Changes to the County Council's partnership with BT - Your Pension Service

Further information can be found on the County Council's website at http://council.lancashire.gov.uk/ieListDocuments.aspx?CId=191&MId=3279&Ver=4
The decisions taken by the Sub-Committee are set out in the minutes of the meeting which are attached at Appendix 'A'.

The Sub-Committee would like to draw the Committee's attention to the following:

1. Public Sector Pension Reform – Changes to the Local Government Pension Scheme as from 1 April 2014

The changes represent the biggest change to Public Sector pension provision in recent memory and have necessitated significant amendments to the Fund's

Lancashire County Council

administration systems and processes. A comprehensive communication campaign to inform employers and scheme members has been underway since 2013.

The Sub-Committee approved revisions to the Pensions Administration Strategy Statement, and the revised Communication Policy Statement.

The Government has just announced that no new Councillors will be eligible to join the LGPS from 1 April 2014. Councillors who are members of the Scheme on 31 March 2014 will be able to continue as members of the Scheme but only until the end of the term of office they are in on 1 April 2014.

2. The Payment of Death Grants

The Sub-committee approved revised procedures in respect of the payment of death grants. The changes are intended to simplify the procedure, to allow the family of the deceased to exercise some autonomy and to give them the option to appoint an independent trustee.

3. Changes to the County Council's partnership with BT - Your Pension Service

The Sub-Committee has welcomed the decision by the County Council to return Your Pension Service to the County Council following changes to the Council's partnership with BT.

Consultations

N/A

Implications:

This item has the following implications, as indicated:

Risk management

No significant risks have been identified.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
N/A		

Reason for inclusion in Part II, if appropriate

N/A

Lancashire County Council

Pension Fund Administration Sub-Committee

Minutes of the Meeting held on Wednesday, 12th March, 2014 at 10.00 am in Assembly Hall - County Hall Preston

Present:

County Councillor Miles Parkinson (Chair)

County Councillors

M Brindle	A Schofield
T Burns	D Westley

Co-opted members

Bob Harvey, (Trade Union representative)
Councillor Mark Smith, (Blackpool Council representative)

1. Constitution: Chair and Deputy Chair; Membership; Terms of Reference

It was reported that the County Council at its annual meeting on 23 May 2013 approved the constitution of the Sub-Committee on the basis of 2 Labour members, 2 Conservative members 1 Liberal Democrat member, 1 trade union co-opted member and 1 co-opted member representing the Lancashire District Councils and Unitary Authorities. The membership of the Sub-Committee and its terms of reference were reported.

It was also reported that the County Council had appointed County Councillors M Parkinson and T Burns as Chair and Deputy Chair of the Sub-Committee for the remainder of the municipal year 2013/14.

Resolved:

(i) That the appointment of County Councillors M Parkinson and T Burns as chair and deputy chair of the Sub-Committee for the remainder of the 2013/14 municipal year be noted.

(ii) That the membership and terms of reference of the Sub-Committee, as now reported, be noted.

2. Apologies

None.

3. Disclosure of Pecuniary and Non-Pecuniary Interests

None.

4. Minutes of the Meeting held on 6 February 2013

The Minutes of the meeting held on 6 February 2013 were presented.

Resolved: That the Minutes of the meeting held on 6 February 2013 be confirmed and signed by the Chair.

5. Public Sector Pension Reform – Changes to the Local Government Pension Scheme

The Sub-Committee considered a report on changes to the Local Government Pension Scheme (LGPS) and the consequential effects on the Fund's administration systems and processes.

As from 1 April 2014 the new LGPS 2014 would be a Career Average Re-valued Earnings (CARE) Scheme and other changes would allow Scheme members more flexibility and affordability in respect of their benefits. All benefits accrued prior to 1 April 2014 would be protected. It was noted that a number of other changes were expected to become effective as from 1 April 2015 when the government's new cost sharing and governance arrangements were due to take place. A further report would be presented once the detail of these changes was known.

The Sub-Committee was informed that the changes represented the biggest change to Public Sector pension provision in recent memory and had necessitated significant amendments to the Fund's administration systems and processes. A major project was underway and was being robustly managed to ensure the 1 April 2014 timescale was met.

The greatest element of the changes was the move from calculating benefits based on final salary to a calculation based on career average pay. This requirement had highlighted the need for Scheme employers to share information with the Fund on a more frequent basis if benefits were to be correctly calculated. The Sub-Committee was informed that the Fund's Pensions Administration Strategy Statement had therefore been amended to reflect the change in administration processes.

The requirement to communicate scheme change to members had become more important than ever and a comprehensive communication campaign had been underway since 2013. Various media had been utilised during the campaign and Scheme employers had been provided with a communications toolkit to support them in communicating the change. Webcasts, road shows and online campaign windows had been used to create awareness and to provide information about the changes to Scheme members. A new online self service system allowed members to view and track their pension benefits. It was planned to undertake further developments to the online system over the next twelve months. The Sub-Committee was informed that the Fund's Communication Policy Statement had been revised to reflect this.

It was noted that additional costs had been incurred as a result of these changes and this was expected to increase the charge to the fund in respect of administration in the current financial year, although the charges would not exceed the lower quartile benchmark as set by the fund.

It was also reported that the Government had just announced that no new Councillors would be eligible to join the LGPS from 1 April 2014. Councillors who were members of the Scheme on 31 March 2014 would be able to continue as members of the Scheme but only until the end of the term of office they were in on 1 April 2014. Further information on this recent change would be communicated as soon as possible.

Resolved:

(i) That the changes to the Local Government Pension Scheme, as set out in the report, be noted.

(ii) That the revised Pensions Administration Strategy Statement, as set out at Appendix 'A' be approved.

(iii) That the revised Communication Policy Statement, as set out at Appendix 'B', be approved.

6. The Payment of Death Grants

The Sub-Committee considered a report on proposed changes to the procedures in respect of the payment of death grants where the beneficiary would be a young adult or child.

The Sub-Committee was informed that a review of the current process in relation to the payment of death grants had been undertaken to ensure that the current procedure complied with both the new Local Government Pension Scheme regulations which become effective on 1 April 2014 and previous Local Government Pension Scheme legislation, where this remained applicable.

The review had resulted in necessary changes to the procedures in respect of the payment of death grants. It was noted that the changes were intended to simplify the procedure, to allow the family of the deceased to exercise some autonomy and to give them the option to appoint an independent trustee. Members also noted that the procedures had been amended to reflect necessary changes following the retirement of the Executive Director for Children and Young People.

Resolved: That the revised procedures in respect of the payment of death grants, as set out in the report and at Appendix 'A' be approved.

7. Changes to the County Council's partnership with BT - Your Pension Service

The Sub-Committee received a report on County Council's decision to make changes to its strategic partnership arrangements with BT.

It was reported that the decision had resulted in the return of Your Pension Service, amongst a range of other services, to the County Council. The change would be effective from 1 April 2014.

Resolved: That the decision by the County Council to return Your Pension Service to the County Council following changes to the Council's partnership with BT be welcomed.

8. Urgent Business

None.

9. Date of Next Meeting

It was noted that the date of the next meeting would be confirmed by the County Secretary and Solicitor in due course.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Pension Fund Committee
Meeting to be held on 27 March 2014

Electoral Division affected: None

Notice of Motion Relating to Socially Responsible Investment Agreed by the County Council
(Appendix 'A' refers)

Contact for further information:
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Executive Summary

A notice of motion was carried by the Full Council at its meeting on 12 December 2014, the text of which is reproduced in the body of this report dealing with issues of environmentally and socially responsible investment, which come within the broad heading of socially responsible investment. The notice of motion asks the officers of the Fund to undertake work aimed at examining potential routes to increase the level of environmental and social responsibility of invested companies and to examine the barriers to a policy of active disinvestment in areas which would appear to be in conflict with the County Council's broader policy agenda.

This report sets out a proposed brief and the potential costs for undertaking a piece of work in response to the notice of motion utilising the Fund's consultancy framework.

Recommendation

That the Committee authorise officers to commission consultancy work to the brief set out in Appendix 'A'.

Background and Advice

The Pension Fund Committee has discussed issues of socially responsible investment on a number of occasions in the last 12 to 18 months, and had previously resolved to await the deliberations of the Law Commission's review of fiduciary duty before taking any further specific actions. This position is similar to that taken by the majority of LGPS funds.

At its meeting on 12 December 2013 the County Council adopted the following notice of motion proposed by County Councillor Dowding

"Lancashire County Council recognises the good reputation and sound financial management of the Lancashire County Pension fund (LCPF) and notes that the Fund has recently won the 'European Institutional Investor of the Year.

In light of the increasing concern in the media nationally and locally about pension funds' investment principles regarding environmental, social and governance issues, Full council asks the Pension Fund officers:

1. *To explore what potential routes there are for further increasing the environmental and social responsibilities of the companies in which the Fund invests while giving due consideration to the fiduciary duty.*

2. *To report on the barriers and challenges, legal and otherwise, to disinvesting from individual investment types, such as those which may be considered to undermine the health improvement, social fairness and carbon-reduction related targets that the County Council aims to reach, and to find out the cost of taking appropriate professional advice including risk and return considerations.*

3. *To investigate what practices and initiatives moves there are nationally to support positive action in this area.*

4. *To report to the Pensions committee on the above."*

In essence the notice of motion seeks to initiate a fairly wide ranging piece of work which examines the practicality, legality, performance risk and cost implications of adopting a range of rules and processes within the Pension Fund's overall investment strategy with the aim of furthering a range of wider policy objectives, while having regard to issues of fiduciary duty.

Officers have considered the options to undertake such a piece of work and believe that to have the necessary credibility it needs to be undertaken by a third party not involved in the Fund's management and decision making processes with significant knowledge and experience of the operation of LGPS Funds and pension funds more generally as well as access to an investment advisory practice. This combination could be delivered by a generalist consultant from the Fund's consultancy framework. A proposed brief for such a piece of work is attached at Appendix 'A', and subject to approval officers will commission the relevant work using the appropriate procurement processes.

The proposed consultancy brief seeks to establish:

- The constraints within the current legal framework in relation to an investment strategy either wholly, or more than at present driven by policy rather than financial or fiduciary considerations;
- The nature and means of implementation of more policy driven investment strategies and the definitions used within such strategies and the resource implications of the need to adopt a more active direct engagement with investee companies;

- An understanding of the potential scale and investment performance impact of both disinvestment and investment driven by any more policy driven strategy looking specifically at the listed equity and credit and fixed income portfolios where some degree of "back testing " is easier to achieve. This would include an analysis of the degree to which any change in policy would impact on achievement of the investment strategy objectives and hence the overall funding level;
- This would allow a view to be expressed on the validity, or otherwise of market commentary on the negative impacts of what are termed "restrictive investment strategies";
- The potential impact of a "positive" tilt in the investment strategy either in whole or in part towards defined policy objectives.

This piece of work will aim to take evidence from as wide a field as possible. However, at this stage the Fund has no agreed definition of what it means by "environmental and social responsibility" beyond the generally accepted dictionary definition of the terms and therefore further work will be required by those undertaking the consultancy exercise to understand whether what is meant goes beyond this definition.

Subject to approval by the Committee, the Fund's Officers will commission the consultancy work as quickly as possible with a view to reporting back at the autumn meeting by which time other work in the same space being undertaken by the LGPS Shadow Scheme Advisory Board is likely to have produced some conclusions which could be looked at alongside the specific piece of work commissioned by the Fund.

Consultations

Informal discussions have taken place with PIRC as the Fund's Governance Adviser and members of the Fund's consultancy framework in order to inform the proposals set out in this report.

Implications:

This item has the following implications, as indicated:

Risk management

Any consideration of a fundamental change in investment strategy presents the Pension Fund and the Committee with a range of risks. The majority of risks will only need to be addressed as part of the process of making a decision on a change in strategy, rather than at this exploratory stage.

The key risk at this stage relates to the effective communication of the Committee's intentions and what the Committee has actually agreed to both fund members and employers. Officers will make use of the Fund's normal communication channels to ensure that accurate information is communicated to all relevant stakeholders.

Financial

Informal discussions with members of the consultancy framework indicate a potential cost of up to £50,000 for this work which would be a charge to the Fund. The potential range of cost is fairly wide as the detailed scope and depth of work required will need to be fully defined in discussion with the chosen provider.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel

Reason for inclusion in Part II, if appropriate

N/A

Appendix A

Consultancy Brief – Socially Responsible Investment Review

Lancashire County Pension Fund wishes to commission advice in relation to various issues relating to the broader social and environmental impacts of its investment activities and is requesting that consultants from its bench respond with a proposal, including scope of work, timescale for completion and an indication of total cost.

BACKGROUND:

Lancashire County Council, which is the administering authority for the Lancashire County Pension Fund recently adopted a notice of motion as follows:

"In light of the increasing concern in the media nationally and locally about pension funds' investment principles regarding environmental, social and governance issues, Full Council asks the Pension Fund officers:

1. To explore what potential routes there are for further increasing the environmental and social responsibilities of the companies in which the Fund invests while giving due consideration to the fiduciary duty.

2. To report on the barriers and challenges, legal and otherwise, to disinvesting from individual investment types, such as those which may be considered to undermine the health improvement, social fairness and carbon-reduction related targets that the County Council aims to reach, and to find out the cost of taking appropriate professional advice including risk and return considerations.

3. To investigate what practices and initiatives moves there are nationally to support positive action in this area.

4. To report to the Pensions committee on the above."

Pension Fund officers consider that in order for the Pension Fund Committee to be able to fully understand the implication of any change in policy that independent third party advice is required.

SKELETON OF TOPICS TO BE ADDRESSED

With reference always to the Council motion above, advice needs to address

1. The relevant legal background to the responsibilities of the County Council in managing Pension Fund investments, including but not limited to:

    a. The interpretation of EU legislation (Directive 2003/41/EC) and how the benefits of members should be interpreted (i.e. purely the financial benefit, or is 'benefit' to be more broadly interpreted?);

   b. The requirement (or convention) for Pension fund management to be considered separately and distinctly from the other activities of the County Council and whether a policy stance integrating management of the Pension Fund with other policy objectives could be in contravention of regulation or other legal principles;

   c. Fiduciary duties and their interpretation in relation to a fund with a government sponsor – consideration of potential liabilities arising, whether to the Council as a whole, members individually or its officers (and commentary on the scale and likelihood of any such liabilities arising)

      It is accepted that the Fund will need to take separate and specific legal advice on these issues should it decide following this work to make any change in its policies.

2. Examples of practice in relation to investment strategies driven by social and environmental responsibility from the private sector and other public sector funds, both in the UK and where relevant, overseas (subject to commentary as to whether any specific overseas practices would be compliant with UK/EU law and regulation)

3. Advice on

   a. The avenues by which pension funds typically seek to influence the social and environmental responsibility of the companies in which they invest and how effective such strategies appear to be.
   b. The evidence available of the impact of disinvestment by a pension fund on a company and the long term impact that such disinvestment has on the ability to influence the social responsibility of the companies in question.
   c. The evidence available in relation to the impact on performance of pension funds which have disinvested from companies on grounds of social responsibility.

4. There is a broad spectrum of definitions available in terms of environmental and social responsibility. Advice is sought about how such definitions or thresholds/appetites for different types of investment can be decided upon and applied by the Pension Fund, with reference to solutions, if any, observed in other funds

5. The notice of motion seeks to understand the implications of applying the Council's health improvement, social fairness and carbon-reduction targets to the Pension Fund's investments. Advice is sought as to the range of companies that may potentially need to be disinvested in order to ensure that the Pension Fund holds no investments that could be seen to undermine such targets. The potential impact upon portfolio performance (both return and risk) should be illustrated using historic performance data for a suitable residual portfolio versus a typical market index and over periods of time considered appropriate for such analysis

6. In addition, the fund has the ability to invest in gilts and bonds, as well as Emerging Markets Debt and other forms of lending together with investments in private equity, infrastructure and property. Similar advice to the point above is sought in relation to the potential impact, if any, of a change in policy stance on these portfolios, although it is accepted that detailed modelling and back testing will not be possible to the same degree in these areas.

7. Concerns that have been raised by market commentators in relation to the implementation of restrictive investment strategies include

    a. the potential for the development of an unbalanced portfolio,
    b. the inability to invest in companies that are resilient in different market conditions,
    c. the potential to miss out on excess returns generated by certain sectors;
    d. the potential impact of 'churning' of the portfolio as policy priorities and direction change over time.

    Advice based on the modelling required at points 5 and 6, validating, challenging or dismissing these concerns, as well as considering other relevant issues associated with such strategies, is invited.

8. Advice is sought as to whether a 'positive investment' strategy, seeking to actively invest in initiatives / companies that are seeking to deliver health improvement, social fairness and carbon-reduction would:

    a. Be permissible within the relevant legal frameworks, either in addition to, or instead of, disinvestment,
    b. If so, whether the performance of such a strategy (in terms of return, risk and volatility) would compare favourably or unfavourably with either the current strategy or the residual strategy modelled at point 5.

9. Any other information, relevant research, advice and comment pertinent to the issues raised by the notice of motion.

Pension Fund Committee
Meeting to be held on 27 March 2014

Electoral Division affected: None

Funding Strategy Statement and Statement of Investment Principles
(Appendices 'A' and 'B' refer)

Contact for further information:
George Graham, (01772) 538102, County Treasurer's Department
george.graham@lancashire.gov.uk

Executive Summary

This report sets out the Fund's revised Funding Strategy Statement following the results of the 2013 formal actuarial valuation of the Fund as noted by the Committee at its meeting of 29 November 2013.

The revised Funding Strategy Statement incorporates the requirements set out in the Fund's Statement of Investment Principles, which itself has been updated to reflect the changes to specific investment strategies relating to particular asset classes, previously approved by the Pension Fund Committee.

Recommendation

The Committee is requested to approve:

1. the revised Funding Strategy Statement, as set out at Appendix 'A'.

2. the revised Statement of Investment Principles, as set out at Appendix 'B'.

Background and Advice

All Local Government Pension Scheme funds in England and Wales are required to publish a Funding Strategy Statement (FSS) in accordance with the Local Government Pension Scheme (Administration) Regulations 2008.

Lancashire County Council, as administering authority of Lancashire County Pension Fund, is required to prepare and publish its funding strategy after consultation with all relevant interested parties involved with the Fund – such as local authority employers; admitted bodies; and scheduled/ resolution bodies.

To comply with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, the Pension Fund's Statement of Investment Principles (SIP) must be reviewed and, if necessary, revised from time to time (and within 6 months of any material change).

Lancashire County Council

The SIP describes the high-level principles governing the investment decision-making and management of the Pension Fund and the policy that has been developed to ensure their implementation. The revised Funding Strategy Statement incorporates the requirements set out in the Fund's Statement of Investment Principles, which itself has been updated (Appendix 'B') to reflect the changes to specific investment strategies relating to particular asset classes, previously approved by the Pension Fund Committee.

Purpose of the Funding Strategy Statement (FSS)

The purpose of the FSS is:

- To establish a clear and transparent fund-specific strategy, which will identify how employers pension liabilities are best met going forward.
- To support the regulatory requirement to maintain as nearly constant employer contribution rate as possible; and
- To take a prudent longer-term view of funding those liabilities.

Legislative Framework

Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 provides the statutory framework from which LGPS Administering Authorities are required to prepare their FSS having regard to:

- CIPFA Pensions Panel “Guidance on Preparing and Maintaining a Funding Strategy Statement 2012”
- Its Statement of Investment Principles (SIP) published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the SIP. In practical terms this means that the FSS will need to be comprehensively revisited at each triennial valuation with an annual review in the interim period linked to the review of the SIP.

The Fund Actuary must have regard to the FSS as part of the Fund valuation process.

The FSS is prepared in consultation with interested parties. These have been defined as participating employers, the actuary and investment consultant (Mercers). The draft FSS has been prepared based on Mercer's advice and the pertinent elements have been shared with participating employers. Members of the Scheme have not been consulted as their benefits are guaranteed by statute, but they will have access to the final statement on the Your Pension Service website.

Contents of FSS

The FSS is prepared under the following headings:

- Purpose of the FSS in policy terms;
- Aims and Purpose of the Pension Fund;
- Responsibilities of the main parties;
- Solvency issues and target funding levels;
- Link to investment policy set out in the Statement of Investment Principles;
- Identification of risks and counter-measures.

Fund Valuation as at 31 March 2013

The triennial Valuation of the assets and liabilities of the Lancashire County Pension Fund as at 31 March 2013 has been carried out by the Fund Actuary, Mercer. The results of the Valuation, including amendments to individual employer contribution rates, will be effective from 1 April 2014.

At headline whole fund level the overall funding level based on the various updated assumptions is around 78% as at the 31 March 2013, compared to 80% at March 2010. This differs from the figures in the regular performance reports because of the revised assumptions. Given the significant negative movements in key elements such as the discount rate this should be seen as a positive result for the Fund.

The results of the 2013 Valuation reveal a funding position of 78%. The Actuary presented these results at the Committee meeting held on 29 November 2013 and the results were also communicated to individual employers at a Directors Briefing on 10 December 2013. Subsequently the Actuary and Fund Officers have held one to one "surgery sessions" with individual employers to assist them in understanding the results of the valuation.

The pertinent elements of the Fund's revised Funding Strategy Statement (FSS), attached at Appendix 'A', was also communicated to employers at the Directors Briefing and at the time of writing discussion is still ongoing with a number of individual Fund employers in respect of their individual employer contribution rates and the options available to them via the revised Funding Strategy Statement.

Section 5 of the FSS set out the deficit recovery plan as follows: -

Underlying the assumptions used in the calculation of the funding target are the following two tenets:

- that the Scheme is expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

This allows us to take a longer term view when assessing the contribution requirements for certain employers. As part of this valuation when looking to potentially stabilise contribution requirements we will consider whether we can build into the funding plan the following:-

- some allowance for changes in market conditions that have occurred since the valuation date;

- some further allowance for interest rates and bond yields to revert to higher levels over the medium to long term.

In considering this the Administering Authority, based on the advice of the Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful.

As part of each valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer (or employer grouping), following a principle of no cross-subsidy between the various employers in the Scheme.

In attributing the overall investment performance obtained on the assets of the Scheme to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates arising from the 2013 actuarial valuation:

- A maximum deficit recovery period of 19 years will apply. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A different period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan below).
- Where increases in employer contribution rates are required from 1 April 2014, following completion of the 2013 actuarial valuation, the increase from the rates of contribution payable in the year 2014/15 may be implemented in equal steps, over a maximum period of 3 years.

The employer contributions will be expressed and certified as two separate elements:

- a percentage of pensionable payroll in respect of the future accrual of benefit
- a schedule of lump sum amounts over 2014/17 in respect of the past service deficit (subject to the review from April 2017 based on the results of the 2016 actuarial valuation).

The contributions for any employer may be varied as agreed by the Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party or internally within the Fund.

The formal Actuarial Valuation Report as at 31 March 2013 is expected to be available no later than 31 March 2014. A copy of the Report will be sent to all members of the Pension Fund Committee.

Consultations

The Fund's Actuary, Mercer, and individual employers, have been consulted on the details of the FSS.

Implications:

This item has the following implications, as indicated:

Risk management

Legal

Non-compliance with statutory regulation.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
Local Government Pension Scheme (Administration) Regulations 2008	2008	Andrew Fox/ County Treasurer's Directorate/ 35916
Statutory Instrument 2009 No.3093 – Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009	2009	Andrew Fox/ County Treasurer's Directorate/ 35916

Reason for inclusion in Part II, if appropriate

N/A

Appendix 'A'

Lancashire County Pension Fund

Funding Strategy Statement 2013

For consideration by Pension Fund Committee on 27 March 2014

Lancashire County Council as administering authority of
Lancashire County Pension Fund

Lancashire County Council

www.lancashire.gov.uk

Contents

Lancashire County Pension Fund

Funding Strategy Statement (FSS)

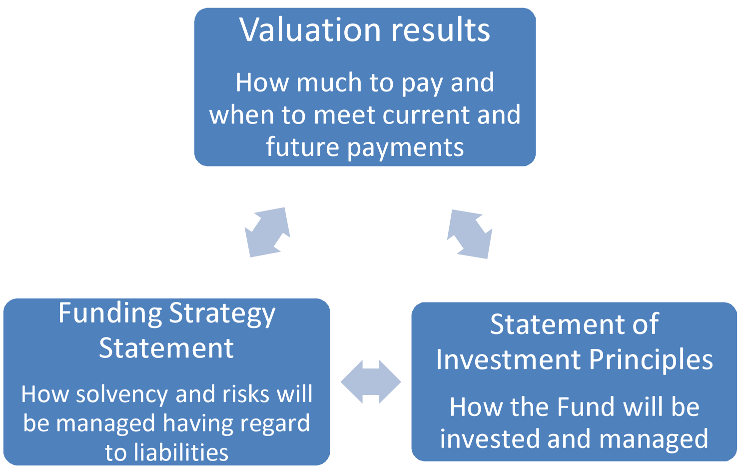
This Statement has been prepared by Lancashire County Council (as Administering Authority) to set out the funding strategy for the Lancashire County Pension Fund (the Fund), in accordance with the Local Government Pension Scheme Regulations and the guidance paper issued in March 2012 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.

1. Introduction

The Local Government Pension Scheme (LGPS) Regulations provide the statutory framework within which the Administering Authority is required to prepare a Funding Strategy Statement. The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the fund the administering authority will prepare and publish its funding strategy;
- In preparing the FSS, the Administering Authority must have regard to:-
  - the guidance issued by CIPFA for this purpose; and
  - the Statement of Investment Principles (SIP) for the Scheme published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended);
- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.
- The FSS should be complete and approved by the Pensions Committee (or equivalent) prior to the completion of each valuation.
- The fund actuary must have regard to the FSS as part of the fund valuation process.

The statements relate as follows:



Benefits payable under the Scheme are guaranteed by statute and therefore the pensions promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.

Employer contributions are determined in accordance with the Regulations which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate. Contributions to the Scheme should be set so as to “secure its solvency”, whilst the actuary must also have regard to the desirability of maintaining as nearly constant a rate of contribution as possible. The actuary must have regard to the FSS in carrying out the valuation.

The Fund is a defined benefit final salary scheme under which the benefits are specified in governing legislation. The required levels of employee contributions are also specified in the Regulations. The Fund, like many other similar public and private sector funded schemes, has a gap between its assets and pension liabilities which this strategy addresses.

A number of factors have contributed to the funding gap and contribution rates for employers:

- Investment returns relative to movements in liabilities;
- Increases in longevity of pensioners;
- Falling long-term interest rates.

There are some steps that the actuary can take to assist employing bodies. These include:

- Recognising the long-term nature of local government, so that deficits are recovered over time;
- Phasing increases in contributions where appropriate;
- Recognising such financial 'improvements' as a reduction in ill-health retirements, prevalence of spouse's and dependants' benefits on a members' death, and anticipated changes to the LGPS being finalised;
- Giving weight to a balanced investment strategy.

The Fund, since it was established in its current form in 1974, has seen variations in its funding level. The funding level has previously been below 70% and subsequently recovered. Over this long period, there has been a consistent approach with the actuarial valuation process, the link to an investment strategy, and balanced management of the risks. The current arrangements continue this approach, and are focussed upon securing diversified investment market returns from global markets. The approach adopted prioritises the achievement of at least market return and, in line with best practice, utilises asset management to deliver a substantial element of the investment target.

2. Purpose of the FSS in policy terms

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the actuary.

The purpose of this Funding Strategy Statement is:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- to support the desirability to maintain as nearly constant a common contribution rate as possible; and
- to take a prudent longer-term view of funding those liabilities.

The Fund currently has a strong net cash inflow (including investment income). The FSS supports the process of ensuring adequate funds are put aside on a regular basis to meet future benefit liabilities. Whilst the LGPS regulations specify the approach and requirements, the implementation of the funding strategy is the responsibility of the Fund acting upon expert advice and following consultation.

The intention is for this strategy to be both cohesive and comprehensive for the fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, its focus should at all times be on those long-term interests of the fund as a whole.

The solvency of the Fund is a long-term management issue. It is essential that funds are made available to ensure that all future pension payments can be met when they become due.

3. Aims and purpose of the Pension Fund

The aims of the fund are to:

- enable employer contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies, whilst achieving and maintaining fund solvency, which should be assessed in light of the risk profile of the fund and the risk appetite of the administering authority and employers alike;
- manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due; and
- seek returns on investment within reasonable risk parameters.

The purpose of the fund is to:

- receive monies in respect of contributions, transfer values and investment income; and
- pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses, as defined in the Local Government Pension Scheme Regulations and as required in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

4. Responsibilities of the key parties

The LGPS regulations set out the responsibilities of the key parties, which are summarised below:

The administering authority (Lancashire County Council) is required to:

- collect employer and employee contributions, investment income and other amounts due to the pension fund as stipulated in LGPS Regulations;
- pay from the pension fund the relevant entitlements as stipulated in LGPS regulations;
- invest surplus monies in accordance with the LGPS Regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- take measures as set out in the regulations to safeguard the fund against the consequences of employer default;
- manage the valuation process in consultation with the fund's actuary;
- prepare and maintain a Funding Strategy Statement and a Statement of Investment Principles, both after proper consultation with interested parties;
- monitor all aspects of the fund's performance and funding and amend Funding Strategy Statement/ Statement of Investment Principles accordingly;
- effectively manage any potential conflicts of interest arising from its dual role as both fund administrator and scheme employer.

The individual employer is required to:

- deduct contributions from employees' pay correctly
- pay all contributions, including their own as determined by the actuary, promptly by the due date
- develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain, and
- notify the administering authority promptly of all changes to active membership which affect future funding.

The fund actuary should:

- prepare valuations including the setting of employers' contribution rates at a level to ensure fund solvency after agreeing assumptions with the administering authority and having regard to the Funding Strategy Statement and LGPS Regulations
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as pension strain costs, ill-health retirement costs, compensatory added years costs, etc
- provide advice and valuations on the termination of admission agreements
- provide advice to the administering authority on bonds or other forms of security against the financial effect on the fund of employer default
- assist the administering authority in assessing whether employer contributions need to be revised between valuations as required by the regulations
- ensure that the administering authority is aware of any professional guidance or other professional requirements which may be of relevance to his or her role in advising the fund.

5. Solvency issues and target funding levels

Including income received from investments, the Fund currently has a strong net cash inflow and can, therefore, take a medium to long-term view on determining employing body contribution rates to meet future liabilities through operating a fund with an investment strategy that reflects this long-term view. It allows short-term investment market volatility to be managed so as not to cause volatility in employing body contribution rates.

The Fund recognises the different characteristics of the variety of participating employer organisations, and will set funding strategy appropriately having regard to factors such as:

- strength of covenant, and security of future income streams;
- support or guarantor arrangements from other Scheme employers, particularly those with tax raising powers;
- prospective period of participation in the Fund, and specifically the implications if the employer has closed membership of the scheme to new employees.

Taking these factors into account, case-by-case assessment and review of contribution requirements may, in some cases, prove necessary as part of the triennial valuation process.

In line with its Admissions and Terminations Policy the Fund will continue to seek either guarantees from existing scheduled employers or external insurance in the form of bonds when considering admitting new employers to the Fund.

In cases where an element of an existing Scheme employer's deficit is transferred to a new employer on its inception, the Scheme employer's deficit recovery contributions, as shown on the schedule to the Rates and Adjustments Certficate, may be reallocated between the Scheme employer and the new employer to reflect this, on advice of the Actuary and as agreed with the Administering Authority.

LGPS Regulations require the long-term funding objectives to achieve and maintain assets sufficient to cover 100% of the projected accrued liabilities. The level of assets necessary to meet this 100% funding objective is known as the 'funding target'. The role of the actuary in performing the necessary calculations and determining the key assumptions used, is an important feature in determining the funding requirements.

Individual employers have a range of discretions available to them in terms of the benefits available to scheme members. Where the exercise of these discretions results in the potential for there to be a loss of future contributions to the Fund or an increased deficit a "strain payment" calculated by the Fund's actuary becomes due to the Fund from the employer immediately.

The approach to the actuarial valuation process and key assumptions used at each three-yearly valuation are consulted upon and the valuation forms part of the consultation undertaken with the FSS.

Determination of the funding target and recovery period

The principal method and assumptions to be used in the calculation of the funding target are set out in Annex 1.

Underlying these assumptions are the following two tenets:

- that the Scheme is expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

This allows us to take a longer term view when assessing the contribution requirements for certain employers. As part of this valuation when looking to potentially stabilise contribution requirements we will consider whether we can build into the funding plan the following:-

- some allowance for changes in market conditions that have occurred since the valuation date;
- some further allowance for interest rates and bond yields to revert to higher levels over the medium to long term.

In considering this the Administering Authority, based on the advice of the Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful.

As part of each valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer (or employer grouping), following a principle of no cross-subsidy between the various employers in the Scheme.

In attributing the overall investment performance obtained on the assets of the Scheme to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates arising from the 2013 actuarial valuation:

- A maximum deficit recovery period of 19 years will apply. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A different period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan below).
- Where increases in employer contribution rates are required from 1 April 2014, following completion of the 2013 actuarial valuation, the increase from the rates of contribution payable in the year 2014/15 may be implemented in equal steps, over a maximum period of 3 years.

The employer contributions will be expressed and certified as two separate elements:

- a percentage of pensionable payroll in respect of the future accrual of benefit
- a schedule of lump sum amounts over 2014/17 in respect of the past service deficit (subject to the review from April 2017 based on the results of the 2016 actuarial valuation).

The contributions for any employer may be varied as agreed by the Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party or internally within the Fund.

On the cessation of an employer's participation in the Scheme, the actuary will be asked to make a termination assessment. Any deficit in the Scheme in respect of the employer will be due to the Scheme as a termination contribution, unless it is agreed by the Administering Authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Scheme to another participating employer.

However, the Administering Authority has ultimate discretion where the particular circumstances of any given Employer warrant a variation from these objectives.

In determining the above objectives the Administering Authority has had regard to:

- the responses made to the consultation with employers on the FSS principles;
- relevant guidance issued by the CIPFA Pensions Panel;

- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose;
- the Administering Authority's views on the strength of the participating employers' covenants in achieving the objective.

Deficit recovery plan

If the assets of the scheme relating to an employer are less than the funding target at the effective date of any actuarial valuation, a recovery plan will be put in place, which requires additional contributions from the employer to meet the shortfall.

Additional contributions will be expressed as annual monetary lump sums, subject to review based on the results of each actuarial valuation.

In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:

- the size of the funding shortfall;
- the business plans of the employer;
- the assessment of the financial covenant of the Employer and the security of future income streams;
- any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.
- length of expected period of participation in the Fund.

The assumptions to be used in these Recovery Plan calculations are set out in Annex 1.

The normal cost of the scheme (future service contribution rate)

In addition to any contributions required to rectify a shortfall of assets below the funding target contributions will be required to meet the cost of future accrual of benefits for members after the valuation date (the "normal cost"). The method and assumptions for assessing these contributions are also set out in Annex 1.

6. Link to investment policy set out in the Statement of Investment Principles

The results of the 2013 valuation show the liabilities to be 78% covered by the current assets, with the funding deficit of 22% being covered by future deficit contributions due from the participating employers.

In assessing the value of the Scheme's liabilities in the Valuation, allowance has been made for asset out-performance as described in [Annex 1], taking into account the investment strategy adopted by the Scheme, as set out in the SIP.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgoings. However, it is possible to construct a portfolio which closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.

Investment of the Scheme's assets in line with the least risk portfolio would minimise fluctuations in the Scheme's ongoing funding level between successive actuarial valuations, assuming that the scheme started in a fully funded position.

If, at the Valuation date, the Scheme had been invested in this portfolio, then in carrying out the Valuation it would not be appropriate to make any allowance for out-performance of the investments.

Departure from a least risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements. The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The current investment strategy, as set out in the SIP, is shown at [Annex 2].

7. Identification of risks and counter-measures

Funding of defined benefits is by its nature uncertain. Funding of the Scheme is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the actuary that the greatest risk to the Scheme's funding is the investment risk inherent in the predominantly equity (or return seeking) based strategy, so that actual asset out-performance between successive valuations could diverge significantly from the overall out performance assumed in the long term.

What are the risks?

Financial

- Investment markets fail to perform in line with expectations;
- Market yields move at variance with assumptions;
- Investment Fund Managers fail to achieve performance targets over the longer term;
- Asset re-allocations in volatile markets may lock in past losses;
- Pay and price inflation significantly more or less than anticipated;
- Effect of possible increase in employer's contribution rate on service delivery and admitted/scheduled bodies.

Demographic

- Longevity horizon continues to expand;
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health).

Regulatory

- Further changes to Regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees;
- Changes to national pension requirements and/or HMRC rules.

Governance

- Administering Authority unaware of structural changes in employer's membership (e.g. large fall in employee numbers, large number of retirements);
- Administering Authority not advised of an employer closing to new entrants;
- An employer ceasing to exist with insufficient funding or adequacy of a bond;
- Changes in Committee membership.

These risks are incorporated as part of a comprehensive Fund risk register referred to in Annex 3 below. Such risks will be monitored and reviewed in line with the monitoring and review guidelines identified elsewhere within the Funding Strategy Statement.

Investments

The responsibility for the investment management of the Lancashire County Pension Fund is detailed in the Statement of Investment Principles and is as follows:

Lancashire County Council is responsible for administering the Fund under the Local Government Pension Scheme Regulations. It discharges its responsibilities through:

- The Pension Fund Committee;
- The Fund's Investment Panel;
- The Fund's Investment Managers.

The division of responsibility is detailed below.

Pension Fund Committee

The Pension Fund Committee has overall responsibility for investment policy and monitoring overall performance. The Committee meets four times a year, and currently comprises 14 elected County Councillors, 4 representatives of the District Councils and Unitary Authorities within the Fund, 2 representatives of scheme members and a representative of the Higher and Further Education Sectors in Lancashire.

The Administering Authority ensures that the members of the Pension Fund Committee receive suitable training each year on Pension Fund issues. In addition to the greatest risk, CIPFA have identified a number of other key risks that are shown at Annex 3 of this document. These risks will be subjected to the monitoring and review process as described in section 8 below.

Investment Panel

The Investment Panel consists of two independent advisors, the Treasurer to the Fund (as Chair), the officer of the County Council fulfilling the role of Chief Investment Officer for the Fund and an officer of the County Council identified by the Treasurer to the Fund to oversee investment compliance activities.

The Panel meets at least quarterly, or otherwise as necessary. The Panel may operate through sub groups to undertake particular tasks. It formulates recommendations to the Treasurer to the Fund and/or the Pensions Fund Committee through meetings of the full Panel.

The Panel is required to provide advice to the Treasurer of the Fund regarding:

a. Recommendations to the Pension Fund Committee in relation to the Investment Strategy for the Fund;
b. The broad composition of the Fund's investment portfolio, management style and types of investment;

c. The proposed procurement process, tender award criteria and evaluation methodology for external advisers and other external assistance including investment managers, property agents and advisors, corporate governance adviser, Fund Custodian, performance measurement advisers, the Fund Actuary and the Fund's AVC Provider ("external support") to enable the Treasurer to the Fund to seek the approval of the Pension Fund Committee to commence the procurement of any required external support.
d. The selection and appointment of any required external support (subject to the role of the Pension Fund Committee), their remit and terms of office;
e. The allocation of ranges and thresholds within which the Investment Managers should operate;
f. Review of the Statement of Investment Principles and compliance with investment arrangements;
g. Recommendations on the detailed management of the investment portfolios including the selection of pooled funds; and
h. To oversee the performance of the investment managers appointed by the Fund and to report on the Fund's performance.

Investment Managers

The management of the Fund’s investments is structured so as to provide diversification of management style and produce an acceptable spread of risk across the portfolio whilst maximising returns.

All Fund managers are subject to investment due diligence and all the segregated fund managers are UK FCA or equivalent organisation. New allocations may be made from time to time and Investment Managers are added to, removed or changed as necessary.

The Fund's Investment Managers are listed in its Annual Report.

8. Monitoring and Review

The Administering Authority has taken advice from the actuary in preparing this Statement, and has also consulted with the following key stakeholders:

- Fund Employers;
- The Pension Fund Committee.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full Actuarial Valuation. Any review will take account of the current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full Actuarial Valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example:

- if there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy

- if there have been significant changes to the Scheme membership, or LGPS benefits
- if there have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy
- if there have been any significant special contributions paid into the Scheme.

Annex 1

Method and assumptions used in calculating the funding target

Method

The actuarial method to be used in the calculation of the funding target is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the scheme on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted (the Attained Age method), which makes advance allowance for the anticipated future ageing and decline of the current closed membership group.

Financial assumptions

Investment return (discount rate)
A yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") of 1.6% p.a.

The asset out-performance assumptions represent the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date.

Inflation (Consumer Prices Index)
The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities but subject to the following two adjustments:

• An allowance for supply/demand distortions in the bond market (an "inflation risk premium") is incorporated and
• An allowance for pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index.

The overall reduction to RPI inflation as implied by the investment markets at the valuation date is 1.0% per annum.

Salary increases
The assumption for real salary increases (salary increases in excess of price inflation) in the long term will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases.

In addition to the long term salary increase assumption allowance has been made for expected short term pay restraint for all employers in the fund. This results in a total salary increase of 1% per annum for 3 years.

Pension increases
Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions in respect of service prior to April 1997).

Mortality
The mortality assumptions will be based on up-to-date information published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the scheme. The mortality tables used are set out below, with a loading reflecting Fund specific experience . The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary. Current members who retire on the grounds of ill heath are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 4 years older whereas for existing ill health retirees we assume this is at an age 3 years older. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a minimum level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a minimum rate of improvement of 1.5% per annum.

The mortality before retirement has also been adjusted based on LGPS wide experience.

Commutation
It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take the standard 3/80ths cash sum. The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up.

Other Demographics
Following an analysis of Fund experience carried out by the Actuary, the incidence of retirement in normal health and in ill health and the proportions married/civil partnership assumption have been modified from the last valuation. Other assumptions are as per the last valuation.

Expenses
Expenses are met out the Fund, in accordance with the Regulations. This is allowed for by adding 0.4% of pensionable pay to the contributions as required from participating employers. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits
The costs of any discretion exercised by an employer in order to enhance benefits for a member through the Fund will be subject to additional contributions from the

employer as required by the Regulations as and when the event occurs. As a result, no allowance for such discretionary benefits has been made in the valuation

Method and assumptions used in calculating the cost of future accrual

The cost of future accrual (normal cost) will be calculated using the same actuarial method and assumptions as used to calculate the funding target except that the financial assumptions adopted will be as described below.

The financial assumptions for assessing the future service contribution rate should take account of the following points:

- contributions will be invested in market conditions applying at future dates, which are unknown at the effective date of the valuation, and which are not directly linked to market conditions at the valuation date; and

- the future service liabilities for which these contributions will be paid have a longer average duration than the past service liabilities.

The financial assumptions in relation to future service (i.e. the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real return (i.e. return in excess of CPI price inflation) of 3% per annum, with a long term average assumption for price inflation of 2.6% per annum. These two assumptions give rise to an overall discount rate of 5.6% p.a.

Adopting this approach the future service rate is not subject to variation solely due to different market conditions applying at each successive valuation, which reflects the requirement in the Regulations for stability in the “Common Rate” of contributions. In market conditions at the effective date of the 2013 valuation this approach gives rise to a somewhat more optimistic stance in relation to the cost of accrual of future benefits compared to the market related basis used for the assessment of the funding target.

At each valuation the cost of the benefits accrued since the previous valuation will become a past service liability. At that time any mismatch against gilt yields and the asset out-performance assumptions used for the funding target is fully taken into account in assessing the funding position.

Summary of key whole Fund financial assumptions used for calculating funding target and cost of future accrual (the "normal cost") for the 2013 actuarial valuation

Long-term gilt yields	
Fixed interest	3.2% p.a.
Index linked	-0.4% p.a.
Past service Funding Target financial assumptions	
Investment return/Discount Rate	4.8% p.a.
CPI price inflation	2.6% p.a.
Long Term Salary increases	4.1% p.a.
Pension increases/indexation of CARE benefits	2.6% p.a.
Future service accrual financial assumptions	
Investment return	5.6% p.a.
CPI price inflation	2.6% p.a.
Long Term Salary increases	4.1% p.a.
Pension increases/indexation of CARE benefits	2.6% p.a.

Demographic assumptions

The post retirement mortality tables adopted for this valuation are as follows:

Life expectancy at 65 in 2013		Base table	Adjustment	Improvement model	Long term rate
CURRENT ANNUITANTS	Normal health	S1PxA	100% / 98%	CMI_2012	1.5%
	Ill health	S1PxA	Normal health + 3 years	CMI_2012	1.5%
	Dependants	S1PMA/S1DFA	158% / 115%	CMI_2012	1.5%
	Future dependants	S1PMA/S1DFA	114% / 105%	CMI_2012	1.5%
CURRENT ACTIVES / DEFERREDS	Actives normal health	S1PxA	100% / 98%	CMI_2012	1.5%
	Actives ill health	S1PxA	Normal health + 4 years	CMI_2012	1.5%
	Deferreds	S1PxA	100% / 98%	CMI_2012	1.5%
	Future dependants	S1PMA/S1DFA	114% / 105%	CMI_2012	1.5%

Other demographic assumptions are noted below

Withdrawal	As for 2010 valuation
Other demographics	Based on LG scheme specific experience.
50:50 Option	Allowance for certain employers

Assumptions used in calculating contributions payable under the recovery plan

The contributions payable under the recovery plan are calculated using the same assumptions as those used to calculate the funding target, with the exception that, for certain employers which are considered by the Administering Authority to provide a high level of financial covenant and are required to increase contributions (compared to the 2014/15 levels that would have been payable under the previous funding plan), an allowance may be made as part of the recovery plan for interest rates and bond yields to revert to higher levels over a period of 5 years.

In isolation, the effect of this increase in yields is to reduce the funding deficit by primarily lowering the value of the fund’s liabilities over time, thus reducing the level of deficit contributions required by the employer during the recovery period.

Increases in yields on fixed and index linked gilts

The impact of the assumed yield reversion described above is taken to be equivalent to an immediate increase in fixed and index linked gilt yields of up to 0.5% p.a.

As indicated above, this variation to the assumptions in relation to the recovery plan can only be applied for those employers which the Administering Authority deems to be of sufficiently high financial covenant to support the anticipation of increased gilt yields over the entire duration of the recovery period. No such variation in the assumptions will apply in any case to any employer which does not have a funding deficit at the valuation (and therefore for which no recovery plan is applicable). Where a funding deficit exists the impact of the anticipated increases in gilt yields will be limited so that the total employer contributions emerging from the valuation will be no less the 2014/15 levels that would have been payable under the previous funding plan.

Annex 2

SIP INVESTMENT STRATEGY

The current investment strategy may be revised in light of the latest actuarial valuation, but will largely follow the same direction set out when the strategy was significantly overhauled in 2010.

In addition, the Investment Panel has had approval to dynamically manage the Fund's interest and inflation rate exposure and the Fund's longevity risk.

The investment strategy sets out a balance between different asset classes as follows:

Asset Class	Range %
Global Equities – Active and Passive, Physical and Index. Private and Publicly Quoted	**40-60**
Diversified Property –UK and Overseas. Direct and indirect.	**10-20**
Lower Volatility Strategies - (including but not exclusively, Fixed Income, PFI, Credit strategies, Infrastructure, Currency, Commodities, Absolute Return, Cash, funds and index, Local development/PPP type allocations)	**20-40**

The Active Public Equity and Fixed Interest Managers have full discretion to invest within each investment category subject to statutory limits and any asset allocation ranges around the benchmark, agreed between the Investment Panel and the Managers. The Property Manager's mandate is advisory with final decisions being taken by the Treasurer to the Fund based upon that advice.

With pooled funds, the manager of the investment fund operates within the constraints imposed by the constitution of the pooled fund, as reviewed and approved by the Investment Panel.

A separate strategy has been approved by the Pension Fund Committee in relation to each of the individual asset classes described in the above table.

Performance Targets

Each manager is expected to achieve an excess return on the assets under their management greater than the relevant benchmark. In assessing performance of each manager the Investment Panel takes in to account the long-term nature of the investment process and returns are judged primarily on an annualised basis over a rolling three-year period. The Investment Panel reviews the appointment of each manager at least every three years or such shorter period as may be necessary.

The targets and benchmarks, where such assets are held, are as follows:

- The Global Equity specialist managers have a target to outperform the MSCI All World index by 2.5% (net of fees) on a rolling three year basis. They are benchmarked against the MSCI All World index.
- The Government Bonds manager is expected to outperform the FTSE All Stocks benchmark performance return by 0.75% (net of fees) on a rolling three year basis.
- The Corporate Bonds manager is expected to outperform the IBOXX sterling Non Gilts benchmark on a rolling three year basis.
- Bonds and cash held for treasury management purposes are expected to outperform the FT 7 day LIBID.
- The Private Equity Manager has a target to outperform the median return in the British Venture Capital Association (BVCA) survey of Private Equity returns by 3%. Historically, the Private Equity benchmark has been the FTSE All Share. Going forward, an absolute return target may be more appropriate, and the Fund's independent advisers have suggested a target in the range 8-12% per annum, with a natural mid-point of 10%.
- The Infrastructure managers are expected to outperform an 8% absolute benchmark on a rolling three year basis.
- The credit and fixed income funds have individual targets and benchmarks relating to their specific sub-class within the overall asset allocation.
- The UK direct property manager is expected to outperform the IPD All Property Index Benchmark return on a rolling three year basis. Overall, and as set out in the property strategy above, the core property strategy targets an Internal Rate of Return (IRR) of 6-8% per annum, whilst the specialist income/ opportunity strategies would be expected to return IRRs of 8-12% per annum.

Annex 3

Key Risks Identified

The following risks, as set out in the Fund's Risk register, will be monitored and reviewed in line with the monitoring and review guidelines identified elsewhere within the Funding Strategy Statement:

- Investment and funding risk;
- Employer risk;
- Skill and resource risk;
- Governance and compliance risk;
- Reputational risk;
- Administration risk.

The measures in place to mitigate the key risks in these areas are detailed below.

Risks and mitigations

Ref	Area	Risk	Cause	Impact	Mitigation in place
I001	Investment and funding risk	Asset / liability mismatch	Assets insufficient to fund liabilities	Inability to make benefit payments, meaning cash injections required from employers	Increasing focus on liability management, new investment strategy, diversified portfolio
I002	Investment and funding risk	Inflation risk	Increases in commodity prices push up the level of inflation	Inflation increases pension payments but assets do not grow at required level	Hold some index linked assets
I003	Investment and funding risk	Concentration of assets	Over reliance of assets in one particular area	A significant allocation in a particular type asset will lead to an over exposure in that area and therefore vulnerabilty to significant changes.	New investment strategy is moving away from a large investment in equities. Amount of the fund in particular assets in governed by the pension fund regulations. Monthly monitoring of asset allocations by Investment Panel.
I004	Investment and funding risk	Falling share prices and therefore asset value	Actions of companies in who the pension fund invests (fraud, poor corporate governance)	Falling share prices and therefore a decrease in the assets held by the fund.	Investment portfolio is diverse in order to minimise such risks. Member of LAPFF and PIRC to promote engagement.
I005	Investment and funding risk	Under performance by fund managers	Fund managers not meeting required returns	Returns achieved lower than those anticipated in funding strategy leading to a greater funding gap	Mixture of active and passive managers, monitoring of investment manager performance, new investment strategy moving to a greater reliance on the internal team.
I006	Investment and funding risk	Liability risk: Discount rate	Market conditions between valuation dates produces a lower discount rate than expected by the actuary	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	Increasing focus on liability management, new investment strategy, diversified portfolio
I007	Investment and funding risk	Liability risk: Inflation rate	Assumed inflation rate within liability valuation applied to future pension increases and salary rises is lower than actual rate	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	Increasing focus on liability management, new investment strategy, diversified portfolio
I008	Investment and funding risk	Liability risk: Salary increase	Salary increases higher than expected (and maybe linked to inflation expectations)	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	Provision for employers to top-up contributions to offset the increasing liabilities.
I009	Investment and funding risk	Liability risk: Longevity	The assumptions of future life expectancy and improvements in life expectancy may be lower than actual. Members may live longer and benefits may be paid for	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	
I010	Investment and funding risk	Liability risk: Early retirement/ ill-health retirement	Members retiring earlier than normal retirement age with no reduction in benefit will require employers to make greater contributions	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	Provision for employers to top-up contributions to offset the increasing liabilities.
I011	Investment and funding risk	Liability risk: Diversification	Diversification of asset portfolio less than expected	Assets move in unpredictable directions, potentially increasing the funding gap between assets and liabilities	Increasing focus on liability management, new investment strategy, diversified portfolio
I012	Investment and funding risk	Liability risk: LGPS Regulations	Pension benefits are governed by statute, and any changes will impact on the fund's liabilities causing them to either increase or decrease	Liabilities are affected by statutory changes to LGPS	Increasing focus on liability management, new investment strategy, diversified portfolio. Lobbying of Government.
I013	Investment and funding risk	Custody risk	Custodian does not adequately meet the requirements of their contract	Problems with custodian leading to missed dividends or corporate actions.	Subscribe to services of Thomas Murray as custodian monitor.
I014	Investment and funding risk	Investment returns below peer groups	Investment managers do not meet the required returns	Reputational risk, increasing gap between assets and liabilities	Regular monitoring and review
I015	Investment and funding risk	Missed investment opporunities	Lack of awareness or slow decision making	Missed investment opportunities could result in reduced returns for the fund	Maintain a good relationship with investment managers and build strength in the internal team. Awareness of timetables and protocols
I016	Investment and funding risk	Mismatch of funding plan and investment strategy	Incorrect assumptions made regarding assets and liabilities	Incorrect contribution rates could be set	Funding strategy and investment strategy to be linked to triennial reviews
I017	Investment and funding risk	Insufficient cash available to meet requirements	Poor management of liquidity	If liquidity is not managed, assets may need to be sold quickly meaning the best price is not achieved	Implement effective cash management strategies
I018	Investment and funding risk	Transition risk of the new investment strategy	Unforeseen events	Incurring unexpected costs while moving the assets	Specialist transition manager has been appointed to oversee this process on behalf of the pension fund.

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Ref	Area	Risk	Cause	Impact	Mitigation in place
E001	Employer Risk	Inability of an employer to meet its contribution requirements due to legislative or actuarial changes.	Increased level of contributions required from employer	Overall fund faces increasing liabilities	Monitor risk picture of the employers, particularly with reference to the size of their liability
E002	Employer Risk	Employer ceasing to exist	Employer closes	If there is insufficient funding, bond of guarantee in place any shortfall will be attributec to the whole fund, thereby increasing the level of	Monitor employers risk profiles and ensure bonds are sufficient
S001	Skill and Resource risk	Key person risk	Someone leaving the organisation and only a limited market from which to seek their replacement	Knowledge gap which it may be difficult to fill	Maintain a system of staff cover; succession planning and development
S002	Skill and Resource risk	Lack of expertise / resources of officers involved in the Pension Fund	Insufficient training or continuous development	Either inappropriate staffing or insufficient resources in a particular area meaning that the fund cannot be managed or administered properly and mistakes are made.	Regular performance appraisals and training plans in place. On the job training.
S003	Skill and Resource risk	Insufficient knowledge of pension fund committee members	Insufficient training or continuous development	Inappropriate decisions taken at committee meetings or inability to make decisions through lack of understanding	Implement training for new members. Have an on-going training requirement for members and officers to ensure knowledge remains up to date. Mixture of in-house and external sessions. Officer expert advice.
S004	Skill and Resource risk	Insufficient external expertise	Failure to employ specialist advisers when their skills are required	Under performance of fund	Employ specialists where appropriate from consultancy bench and develop in-house expertise
S005	Skill and Resource risk	Inappropriate decision making	Production of poor or inappropriate performance management information	Incorrect decisions being taken due to the reliance on this information	Use of independent Custodian. Implement regular monitoring in an agreed format. Regular monitoring of performance information and on-line access to NT Passport system.
G001	Governance and compliance risk	Non compliance with LGPS regulations	Lack of technical expertise / staffing to research any regulation changes	Non compliance with legislation change could result in penalties or sanctions leading to financial loss	Monitor legislative changes, engage in consultations, attend pension update briefings / courses.
G002	Governance and compliance risk	Non compliance with investment policies	Lack of understanding of investment policies	Non compliance with investment policies could increase the risk profile of the fund.	Periodic monitoring of investment types against regulations. Individual investments checked in advance of commitment as part of internal Due diligence.
G003	Governance and compliance risk	Production of incorrect financial statements	Production of misleading information and misleading stakeholders	Misunderstanding or wrong decisions	Review and sign off process in place.
G004	Governance and compliance risk	Conflict of interest	Officers or members fail to declare a conflict of interest leading to decisions that are not in the best interest of the fund	Inappropriate decisions taken	Training on what constitutes a conflict and ensuring register of interests/ gift and hospitality entries are made where appropriate.
G005	Governance and compliance risk	Failure to minute meetings correctly	Important decisions are not documented and then there is no record of them when evidence of the decision is	Unable to prove that a decision has been taken	All meetings to be minuted and agreed by members
G006	Governance and compliance risk	Failure to implement an proper monitoring system	Performance of the fund cannot be monitored over time	Incorrect decisions are taken	Implement a regular monitoring system
G007	Governance and compliance risk	Information loss (intellectual property and confidential information)	Sensitive information could be lost damaging the reputation of the fund and putting the fund members at risk	Damaged reputation / litigation risk	Ensure confidential information is secure
G008	Governance and compliance risk	Information governance	Loss of information which means that the fund is unable to operate	Unable to undertake day to day functions	Back up of ICT network. Use of Northern Trust web-based Passport system.
G009	Governance and compliance risk	Non-existent assets	The risk that assets purchased by the pension fund do not exist, or fund managers are not bona fide.	Misrepresentation of assets held. Reputational damage.	Due diligence undertaken as part of investment review process either by Fund officers or investment consultants.
R001	Reputational risk	Actions damage the perception of the fund	Reputation of the fund will be damaged which may impact on participation rates and investment strategies		Good governance, open communication. Use of PIRC/ LAPFF to engage with shareholder companies to encourage good governance.
A001	Administration risk	Failure to process pension payments and lump sums on time	Unavailability of IT / staff, or errors	Maintenance of IT, staff cover and training	Testing of system including audit
A002	Administration risk	Failure to collect contributions from employers and employees	Unavailability of IT / staff, or errors or poor communication	Maintenance of IT, staff cover and training	Robust back-up systems in place
A003	Administration risk	Inability to provide service due to loss of facilities	Fire, flood etc	Unable to provide service	Business continuity
A004	Administration risk	Loss of funds through fraud	Fraud or misappropriation of funds	Financial loss to fund	Internal controls – separation of duties. Internal and external audit reviews.
A005	Administration risk	Failure to hold personal data securely	Poor procedures for data transfer, data retention and back	Data is lost or compromised	Internal ICT controls. Information governance awareness.
A006	Administration risk	Failure to keep records up to date	Poor or non-existent notification of changes	Incorrect records held and therefore incorrect pensions paid	Documented internal controls. Robust training. Regular monitoring.

Appendix 'B'

Lancashire County Pension Fund

Statement of Investment Principles

For consideration by Pension Fund Committee on 27 March 2014

Lancashire County Council
as administering authority of
Lancashire County Pension Fund

Lancashire County Council

www.lancashire.gov.uk

Contents

Lancashire County Pension Fund

Statement of Investment Principles

1. Introduction

Lancashire County Council ("LCC") is the administering authority of the Lancashire County Pension Fund (the "Fund"). This Statement of Investment Principles ("SIP") sets out the principles governing its decisions about investments made by the Fund It has been prepared in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

The Fund has produced the SIP following consultation with the Fund's Investment Panel, and a representative of the Fund's Actuary.

2. Responsibility for Investment Management

Lancashire County Council is responsible for administering the Fund under the Pension Scheme regulations 1997 (as amended). It delegates its responsibilities to:

- The Pension Fund Committee;
- The Administration Sub Committee;
- The Fund's Investment Panel;
- The Fund's Investment Managers.
- The Fund's Custodian
- The Treasurer to the Fund

The division of responsibility is set out in detail in the Governance Policy Statement, which is available at www.yourpensionservice.org.uk or on request from the Fund, but in summary, responsibilities are allocated as follows:

3. Pension Fund Committee

The Pension Fund Committee has overall responsibility for investment policy and monitoring overall performance. The Committee meets four times a year, and currently comprises 14 elected County Councillors, 4 representatives of the District Councils and Unitary Authorities within the Fund, 2 representatives of scheme members and a representative of the Higher and Further Education Sectors in Lancashire.

4. Investment Panel

The Investment Panel consists of two independent advisors, the Treasurer to the Fund (as Chair), the officer of the County Council fulfilling the role of Chief Investment Officer for the Fund and an officer of the County Council identified by the Treasurer to the Fund to oversee investment compliance activities.

The Panel meets at least quarterly, or otherwise as necessary. The Panel may operate through sub groups to undertake particular tasks. It formulates recommendations to the Treasurer to the Fund and/or the Pensions Fund Committee through meetings of the full Panel.

The Panel is required to provide advice to the Treasurer of the Fund regarding:

a. Recommendations to the Pension Fund Committee in relation to the Investment Strategy for the Fund;
b. The broad composition of the Fund's investment portfolio, management style and types of investment;
c. The proposed procurement process, tender award criteria and evaluation methodology for external advisers and other external assistance including investment managers, property agents and advisors, corporate governance adviser, Fund Custodian, performance measurement advisers, the Fund Actuary and the Fund's AVC Provider ("external support") to enable the Treasurer to the Fund to seek the approval of the Pension Fund Committee to commence the procurement of any required external support.
d. The selection and appointment of any required external support (subject to the role of the Pension Fund Committee), their remit and terms of office;
e. The allocation of ranges and thresholds within which the Investment Managers should operate;
f. Review of the Statement of Investment Principles and compliance with investment arrangements;
g. Recommendations on the detailed management of the investment portfolios including the selection of pooled funds; and
h. To oversee the performance of the investment managers appointed by the Fund and to report on the Fund's performance.

5. Investment Managers

The management of the Fund’s investments is structured so as to provide diversification of management style and produce an acceptable spread of risk across the portfolio whilst maximising returns.

All Fund managers are subject to investment due diligence and all the segregated fund managers are registered with the UK FCA or equivalent organisation. New allocations may be made from time to time and Investment Managers are added to, removed or changed as necessary.

The Fund's Investment Managers are listed in its Annual Report.

Role of Lancashire County Council in-house staff in respect of the accounts and investments of the Pension Fund

Under the Lancashire County Council Scheme of delegation to Chief Officers, the Treasurer to the Fund is responsible for carrying out, in consultation with the Investment Panel, the County Council's duties under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, with regard to the requirement to review the investments made by the Fund Managers. The Treasurer reports to each meeting of the Pension Fund Committee.

The Treasury and Investment, Financial Accounting and Taxation and Investment Compliance Teams within the County Treasurer's Directorate support the Treasurer in respect of their Pension Fund investment and accounting responsibilities and provide the following services:

- Investment management services;
- Production of the Pension Fund Annual Report;
- Preparation and maintenance of the accounts and balance sheet of the Pension Fund;
- Verification and monitoring of the investment data produced by the Fund managers to independent custodian records;
- Completion of various statistical questionnaires;
- Preparation of agenda, working papers and reports for the Investment Panel meetings, Pension Fund Committee meetings and other miscellaneous investment meetings;
- Maintenance of Pension Fund internal cash account and investment of Pension Fund Cash not held by the investment managers;
- Provision of accounting data for IAS19 calculations;
- Monitoring compliance with policy laid down by the Investment Panel and Pension Fund Committee;
- Maintenance of regular dialogue with investment managers and custodians;
- The provision of data for performance monitoring and interpretation of performance results;
- The conducting of procurement exercises to secure the services of Investment Managers and other service providers on behalf of the Fund.
- The identifying of and conducting of due diligence on individual investment opportunities for consideration by the Investment Panel.
- Monitoring voting action by the managers;
- Advice to the Treasurer on Pension Fund Investment issues;
- Verification, monitoring and payment of Pension Fund fee invoices;
- Monitoring the receipt of income due to the Fund;
- Representing the Treasurer at the Local Authority Pension Fund Forum meetings and other relevant Pension Fund Investment meetings;
- Interpretation and implementation of the requirements of new legislation relating to Pension Fund accounting and investments;
- Attendance at various seminars covering new developments in respect of Pension Fund Investment issues; and
- Research initiatives.

6. Investment Objectives

The Fund has two objectives in terms of its investment activities:

1. To ensure that resources are available to meet the Fund's liabilities through achieving investment performance at least in line with actuarial assumptions.
2. To achieve full funding (i.e. no funding deficit) over a period no longer than the current recovery period.

The current funding target assumptions include an assumed investment return (discount rate) of a yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") of 1.6% p.a.

The asset out-performance assumptions represent the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date.

7. Types of Investment

The Investment Panel ("the Panel") will provide expert professional advice to the Pension Fund Committee in relation to investment activities that fall within its approved strategy, including the following categories of investment:

- Equities;
- Fixed interest and index linked securities;
- Property;
- Cash; and
- Commodities.

Advice will include the management of foreign exchange risk and the use of financial derivatives where appropriate.

Advice on equities will involve the use of active and passive management styles, the use of public and private markets, and the choice of Investment Managers and pooled funds.

Advice on fixed interest and index linked securities will involve the use of investment grade and non-investment grade credit, and the choice of Investment Managers, pooled funds and direct investment opportunities.

Property advice will include the direct acquisition of land and premises, the development of such land, and improvements and refurbishment of such premises. It will also include the use of indirect pooled property investments.

Investments in infrastructure may be separately grouped, but they fall within the above categories.

8. Balance between Different Types of Investment

The investment strategy sets out a balance between different asset classes as follows:

Asset Class	Range %
Global Equities – Active and Passive, Physical and Index. Private and Publicly Quoted	**40-60**
Diversified Property –UK and Overseas. Direct and indirect.	**10-20**
Lower Volatility Strategies - (including but not exclusively, Fixed Income, PFI, Credit strategies, Infrastructure, Currency, Commodities, Absolute Return, Cash, funds and index, Local development/PPP type allocations)	**20-40**

The Active Public Equity and Fixed Interest Managers have full discretion to invest within each investment category subject to statutory limits and any asset allocation ranges around the benchmark, agreed between the Investment Panel and the Managers. The Property Manager's mandate is advisory with final decisions being taken by the Treasurer to the Fund based upon that advice.

With pooled funds, the manager of the investment fund operates within the constraints imposed by the constitution of the pooled fund, as reviewed and approved by the Investment Panel.

The broad target ranges of the overall investment strategy set out above are supplemented by specific strategies relating to individual asset classes. Pension Fund Committee has approved the following sub-strategies:

- Credit and Fixed Income – approved on 22 March 2013;
- Private Equity – approved on 6 September 2013;
- Property – approved on 6 September 2013.

CREDIT AND FIXED INCOME STRATEGY – BROAD ALLOCATIONS

The table below sets out proposed strategic allocation ranges to the various categories of investment which make up the credit and fixed income universe.

The ranges set out are in line with the Investment Strategy range of 20% to 40% for Lower Volatility Strategies (defined as including but not exclusively, Fixed Income, PFI, Credit strategies, Infrastructure, Currency, Commodities, Absolute Return, Cash, funds and index, Local development/PPP type allocations).

The broad allocations below imply that at a minimum, 20% of the fund allocation will be to credit and fixed income (compared to a current exposure to such strategies of 26.1% of the Fund), leaving up to 20% available for investment in other lower volatility strategies. Flexibility remains within the allocations below for the entire lower volatility allocation to be invested in credit should it be considered appropriate.

Credit investment allocation	% of Fund
Long Dated Secured Lending – Real Estate, Infrastructure and Asset Finance	5%-10%
Senior Secured Loans and Direct Lending to SMEs	5%-10%
Emerging Market Local Currency Debt	5%-10%
Impaired Credit and Regulatory Driven	5%-10%
Balanced / Club Credit Opportunities Funds (may incorporate the above allocations)	0%-20%
Investment Grade Bonds, Gilts and Cash (safe haven / interim holdings only)	0%-20%

PRIVATE EQUITY STRATEGY

Private equity is an illiquid investment, for which this increased illiquidity is compensated by the potential for superior returns (i.e. an illiquidity premium).

The new strategy proposes allocating more capital to fewer funds, thereby reducing diversification. However, these investments may be shared across a wider range of managers, but it is not considered that the portfolio risk will be materially higher.

Co-investing in individual deals alongside a fund manager risks negative selection bias, whereby the fund managers offer co-investments in the less attractive opportunities. This risk appears modest and is offset by the fee reduction.

Changes in the strategy are expected to be gradual over a number of years, such that there will be no sudden changes in the portfolio.

PE Strategy Limits (by Fund Type and Geography)

Strategy limits reflect the market and also give the LCPF fund manager the opportunity to be over/ under weight the market:

	Assume Pension Fund Value (£m) 5,000	**% of PE Allocation**		**% of Pension Fund**		**Example for £5bn Pension Fund (£m)**	
		Min	Max	Min	Max	Min	Max
	Fund Type		100%		7.5%		375
1	**Buyouts (LBOs)**	70%	100%	5.25%	7.50%	263	375
2	**Venture Capital (VC)**	0%	10%	0%	0.8%	0	38
3	**Other PE Sub-Classes**	0%	20%	0%	1.5%	0	75
3.1	Max in Any Single Sub-Class	0%	10%	0%	0.8%	0	38
	Geography						
	Europe (incl. U.K.)	50%	75%	3.8%	5.6%	188	281
	Non-Europe	25%	50%	1.9%	3.8%	94	188
	Developed Markets	90%	100%	6.8%	7.5%	84	188
	Emerging Markets	0%	10%	0%	0.8%	0	38

"Emerging Markets" are as defined by MSCI or FTSE listed indices

Concentration Limits (by Fund Structure)

Limits are set on the concentration by fund structure with the aim of ensuring a minimum level of diversification, but discouraging over diversification:

Commitment Limits per individual PE Fund (as a % of annual PE commitment target)	Target	Min.	Max	Total PE Portfolio Limit (% of NAV)
Primary Fund	15%	7%	25%	100%
Co-Investment Fund	15%	7%	25%	40% incl Direct
Primary Fund of Fund	20%	10%	30%	50%
Secondary Fund	20%	10%	40%	50%

Direct Co-Investments by LCPF in individual companies (as % of the original fund's investment)		20%	100%	40% incl Co-Investment Funds

The central expectation is to commit to 4-6 funds per year, mostly primary, allowing for larger commitments to more diversified funds of funds. In addition to initial commitments to funds, direct co-investments are allowed in individual companies that are held by LCPF's funds.

PROPERTY INVESTMENT STRATEGY

The aim of the Property Investment Strategy is to deliver solid, reliable property returns to the Fund through a diversified portfolio of investments. It aims not only to reduce volatility by seeking exposures across property sectors and geographies but also offer the prospect of higher returns through appropriate diversification and specialist/opportunity investment.

It is proposed that the aim of the property portfolio should be to deliver an absolute return to the Fund rather than track a particular property benchmark. Such an approach promotes long term value decision-making over shorter term drivers to meet a particular index benchmark performance. However, the volatility of returns means that evaluation of performance against an absolute return benchmark is most meaningful when undertaken over longer periods of time.

For performance reporting purposes, it is proposed that an absolute benchmark of 8% per year is used, the same as for the infra-structure investment allocation. In judging the results of individual constituents of the property portfolio, especially in the shorter term, then specialist property benchmarks may be used.

As the absolute benchmark reporting will only become meaningful after a number of years, it is proposed the performance of the property portfolio is also measured against the existing broad IPD UK property index. This performance measure will also measure the value of adding diversity into the property portfolio beyond the existing direct UK portfolio.

The portfolio construction will be influenced not only by the net returns available, but also by the correlation and volatility of returns across sectors and geographies. The value leakage between gross and net returns needs to be taken into account because it varies significantly depending on the investment route chosen.

It is proposed that the mainstay of the property allocation should be to a core property portfolio with additional investments seeking some diversification and higher returns. Where core strategies might have an Internal Rate of Return (IRR) of 6-8% per annum, the specialist income/opportunity strategies would be expected to return IRRs of 8-12% per annum:

	Banded ranges		**Example £m**
Value of Fund			5000
Percentage allocation to property			15%
Total Property Allocation			750
Diversified Core Portfolio	**Range**	**70% to 80%**	525 to 600
Specialist / Opportunity Portfolio	**Range**	**20% to 30%**	150 to 225

This combination of core and specialist holdings offers the prospect of at least achieving the 8% per annum absolute return benchmark proposed if not exceeding it.

<u>Investment Limits imposed under the Local Government Pension Scheme (Management and Investment of Fund's) Regulations 2009</u>

The 2009 regulations laid down the limits shown in Column 1 and Column 2 below, having consolidated the previous 1998, 2003, and 2005 Regulations. The limits in Column 2 may be used by Local Authority Pension Funds if, following proper advice, they have sought approval by their Pension Fund Committees for the increases and the reasons for adopting the increases are detailed in the Statement of Investment Principles.

The Fund's Investment Panel and Pension Fund Committee have previously reviewed the 2009 Regulations limits and have adopted the increased limits for **any single insurance contract** and also for **all contributions to partnerships**.

The 2013 amendment to the 2009 Regulations increased the maximum proportion of a local government pension fund which can be invested in contributions to partnerships from 15% to 30%.

	Column (1) **Limits under regulation 14 (2)**	**Column (2)** **Limits under regulation 14 (3)**
1. Any single sub-underwriting contract.	1%	5%
2. All contributions to any single partnership.	2%	5%
3. All contributions to partnerships.	5%	30%
4. with the sum of - (a) all loans; and (b) and deposits with - (i) any local authority, or (ii) any body with power to issue a precept of requisition to a local authority, or to the expenses of which a local authority can be required to contribute, which is an exempt person (within the meaning of the Financial Services and Markets Act 2000(a)) in respect of accepting deposits as a result of an order made under section 38(1) of that Act, and all loans.	10%	-
5. All investments in unlisted securities of companies.	10%	15%
6. Any single holding.	10%	-
7. All deposits with any single bank, institution or person (other than the National Savings Bank).	10%	-
8. All sub-underwriting contracts.	15%	-

	Column (1) Limits under regulation 14 (2)	Column (2) Limits under regulation 14 (3)
9. All investments in units or other shares of the investments subject to the trusts of unit trust schemes managed by any one body.	25%	35%
9a. All investments in open-ended investment companies where the collective investment schemes constituted by the companies are managed by any one body.	25%	35%
9b. All investments in units or other shares of the investments subject to the trusts of unit trust schemes and all investments in open-ended investment companies where the unit trust schemes and the collective investment schemes constituted by those companies are managed by any one body	25%	35%
10. Any single insurance contract.	25%	35%
11. All securities transferred under stock lending arrangements.	25%	35%

Stock Lending

Stock lending is undertaken up to the 35% limit above. The programme is run by the Fund's Custodian, which monitors performance, limit and counterparty credit adherence, and voting requirements.

9. Policy on Risk

The consideration of investment risk forms part of the Pension Fund's overall risk register, which is presented to Pension Fund Committee on a bi-annual basis. The key risks and associated mitigations are replicated in the Funding Strategy Statement.

The overriding objective of the Fund in respect of its investments is to minimise risk and maximise return while reducing volatility. The structure of the investment management arrangements has been implemented in order to produce a balanced spread of risk for the portfolio.

Operational risk is minimised by having custody of the Fund's financial assets provided by a regulated, external, third party, professional custodian.

The Fund's Global Custodian is Northern Trust. All public market investments are held in nominee accounts of Northern Trust.

All private market investments, including interests in private equity, property and other pooled funds are held directly in the name of Lancashire County Council as administering authority of the Lancashire County Pension Fund. Northern Trust provides detailed investment accounting and reconciliation services for all private market investments.

The title deeds in respect of the Fund's property holdings are held by Lancashire County Council and its property solicitors.

10. The expected return on investments

Each manager is expected to achieve an excess return on the assets under their management greater than the relevant benchmark. In assessing performance of each manager the Investment Panel takes in to account the long-term nature of the investment process and returns are judged primarily on an annualised basis over a rolling three-year period. The Investment Panel reviews the appointment of each manager at least every three years or such shorter period as may be necessary. The targets and benchmarks in place are as follows:

- The Global Equity specialist managers have a target to outperform the MSCI All World index by 2.5% (net of fees) on a rolling three year basis. They are benchmarked against the MSCI All World index.
- The Government Bonds manager is expected to outperform the FTSE All Stocks benchmark performance return by 0.75% (net of fees) on a rolling three year basis.
- The Corporate Bonds manager is expected to outperform the IBOXX sterling Non Gilts benchmark on a rolling three year basis.
- Bonds and cash held for treasury management purposes are expected to outperform the FT 7 day LIBID.
- The Private Equity Manager has a target to outperform the median return in the British Venture Capital Association (BVCA) survey of Private Equity returns by 3%. Historically, the Private Equity benchmark has been the FTSE All Share. Going forward, an absolute return target may be more appropriate, and the Fund's independent advisers have suggested a target in the range 8-12% per annum, with a natural mid-point of 10%.
- The Infrastructure managers are expected to outperform an 8% absolute benchmark on a rolling three year basis.
- The credit and fixed income funds have individual targets and benchmarks relating to their specific sub-class within the overall asset allocation.
- The UK direct property manager is expected to outperform the IPD All Property Index Benchmark return on a rolling three year basis. Overall, and as set out in the property strategy above, the core property strategy targets an Internal Rate of Return (IRR) of 6-8% per annum, whilst the specialist income/ opportunity strategies would be expected to return IRRs of 8-12% per annum.

11. Monitoring and Review

The investment activities of the Fund’s Investment Managers are reviewed at each Panel meeting and reported on to the Pension Fund Committee. At these meetings, asset allocation and investment performance of the Investment Managers is reviewed.

The WM survey of Local Authority Pension Fund returns is also used by the Fund for comparative information purposes.

The Fund's Actuary carries out a triennial review of the Fund and sets the employers' contribution rates for each three year period. Details of investment strategy and activity are an important element of the actuarial review.

The Annual Report is produced by the Treasurer for all employing bodies within the Fund, and this report, together with various information bulletins produced in respect of the Pension Scheme, provides details of Investment Policy and performance relating to the Investment Managers. Extracts from the Report are circulated to all members with the Fund's newsletter and are posted on the Fund's web site (www.yourpensionservice.org.uk).

12. Policy on Realisation of Investments

As the Fund is cash flow positive after including investment income, there is no need to realise investments in order to pay for benefits.

The Fund Managers realise investments as and when they consider appropriate in accordance with their management discretion. The Treasurer having received advice from the Investment Panel approves the realisation of pooled funds and properties.

Where investments are held in portfolios with a discretionary investment mandate, the funds realised are held to the account of the Investment Manager for reinvestment. In all other cases, the funds realised are as cash and managed through the Fund's usual treasury management processes.

13. Social, Environmental and Ethical Considerations

The Fund takes an active stance on corporate governance issues. It uses Pensions Investment Research Consultants ("PIRC") to vote on its behalf at shareholder meetings. PIRC advises on Socially Responsible Investment issues and issues voting guidance and commentary for shareholder meetings. PIRC is instructed to vote the Fund's shares in accordance with its guidelines unless an Investment Manager requests a different vote for investment management reasons. In the latter case, the Treasurer to the Fund will decide how best to cast the vote in the long-term financial interest of the Fund.

The Fund is a member of the Local Authority Pension Fund Forum ("LAPFF"), which is a group of like-minded local authority pension funds that meet to discuss and act / engage in respect of Socially Responsible Investment and Corporate Governance issues.

14. Principles of Investment Practice

The Fund's compliance with the six principles of investment practice laid out in Local Government Pension Scheme (Management and Investment of funds) regulations 2009 is described below:

Principle 1: Effective Decision Making

Fully compliant: The decision making process is fully outlined in the Governance Policy Statement, Governance Compliance Statement and Statement of Investment Principles.

Principle 2: Clear Objectives

Fully compliant: The overall objective for the Fund is outlined in the Statement of Investment Principles. The Investment Panel sets benchmarks for measuring the performance of each investment and an overall benchmark for the Fund as a whole in order to monitor the attainment of the objectives.

Principle 3: Risk and liabilities

Fully compliant: The Investment Panel and Pension Fund Committee have considered the appropriate assets for the Fund following Asset/ Liability studies and decided upon an investment strategy involving a diversification of investments amongst equities, property and investments offering the prospect of acceptable returns with lower volatility.

Principle 4: Performance assessment

Fully compliant: Investment performance reports are produced by the Custodian monthly for consideration by the Investment Panel and the Pension Fund Committee. In addition, StateStreet WM produces quarterly benchmarking information for the Pension Fund to compare performance with other LGPS schemes.

Principle 5: Responsible ownership

Fully compliant: PIRC has been appointed the Fund's proxy to vote the Fund's shares at shareholder meetings. PIRC votes in accordance with its voting guidelines unless an Investment Manager requests differently, in which case the Treasurer to the Fund would decide how the vote should be cast in the best interests of the Fund. The Fund is a member of the Local Authority Pension Fund Forum, which is primarily concerned with Corporate Governance issues and shareholder activism. Voting action is monitored on a quarterly basis.

Principle 6: Transparency and reporting

Fully compliant: The Statement of Investment Principles outlines who is responsible for strategic and asset allocation decisions for the Fund and the reasons behind this Structure. It contains the current investment objective and details of the operational aspects of the Fund’s investments.

The Fund provides all of its Members with regular information bulletins. The Annual Report and the Fund's statutory statements are made available to all the Fund's employers and members through the web site www.yourpensionservice.org.uk.

Pension Fund Committee
Meeting to be held on 27 March 2014

Electoral Division affected:
None

Lancashire County Pension Fund Risk Register
(Appendix 'A' refers)

Contact for further information:
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Andrew.fox@lancashire.gov.uk

Executive Summary

Lancashire County Council as administering authority of Lancashire County Pension Fund has responsibility for ensuring that there is effective risk management in place in relation to the operations of the Fund. This requirement is reflected in both the investment regulations and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

Accordingly, a risk register has been produced (Appendix 'A' refers) which seeks to systematically identify, assess, and evaluate the risks faced by the Pension Fund, and consider the current and future mitigating controls that may be required to manage these risks effectively.

Risk owners will be required to manage the risks for which they are responsible and the risk register will be updated periodically as a result. Updates will be reported to the Pension Fund Committee on a regular basis, and at least annually.

Recommendation

The Committee is asked to approve the Lancashire County Pension Fund Risk Register.

Background and Advice

Risk management is the practice of identifying, analysing and controlling in the most effective manner all threats to the achievement of the strategic objectives and operational activities of the organisation.

It is not a process for avoiding or eliminating risk although that may be a consequence of the risk mitigation measure deployed. A certain level of risk is inevitable in achieving objectives, particularly in an operation such as the Pension Fund which is exposed to a wide range of investment related risks but it must be controlled.

Lancashire County Council

The Pension Fund Committee is the body charged with exercising the County Council's responsibilities as administering authority of the Pension Fund, and accordingly takes the responsibility for ensuring that there is effective risk management over those operations.

Consequently the need for effective risk management is reflected throughout guidance and regulation in the Local Government Pension Scheme (LGPS), notably in Regulation 12(2) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

In addition, the most recent guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) in 2012 entitled 'Managing Risk in the Local Government Pension Scheme' suggests that "risk management lies at the heart of the governance process and effective risk management is a clear indicator of good governance practices."

The register included as Appendix 'A' seeks to assess specific risks relating to Lancashire County Pension Fund and introduce a measure of consistency into the risk assessment process. The risk scores relating to residual risks can then be prioritised.

The objectives of the Risk Register are therefore to:

- identify key risks to the achievement of the Fund’s objectives and day to day operations;
- consider the risks identified and assess their significance in terms of likelihood of the risk materialising and the severity of the impact/consequences if they do occur;
- assess the risk mitigation controls/ procedures currently in place in terms of their effectiveness and consider whether further measures are required.

The risk areas are categorised as:

- Investment and funding risk;
- Employer risk;
- Skill and resource risk;
- Governance and compliance risk;
- Reputational risk; and
- Administration risk.

Planned actions, timescales, review dates, and direction of travel are noted for each risk, alongside the 'risk owner' responsible for managing it.

The Risk Register will be kept under continual review by the nominated risk owners, with the intention of reporting to Pension Fund Committee on a regular basis, and at least annually. The future reporting of the Risk Register will prioritise the identified risks into risk order with the highest risks being suitably highlighted. Any new risks, and significant changes to existing risks will also be noted separately.

Consultations

N/A

Implications:

This item has the following implications, as indicated:

Risk management

The Pension Fund Committee is the body charged with exercising the County Council's responsibilities as administering authority of the Pension Fund, and accordingly takes the responsibility for ensuring that there is effective risk management over those operations.

The register included as Appendix A seeks to assess specific risks relating to Lancashire County Pension Fund and introduce a measure of consistency into the risk assessment process.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
Statutory Instrument 2009 No.3093 – Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.	1 December 2009	Andrew Fox/ County Treasurer's Directorate/ x35916
Chartered Institute of Public Finance and Accountancy (CIPFA) - 'Managing Risk in the Local Government Pension Scheme'	2012	Andrew Fox/ County Treasurer's Directorate/ x35916

Reason for inclusion in Part II, if appropriate

N/A

LANCASHIRE COUNTY PENSION FUND

RISK REGISTER

MARCH 2014

1. Objectives of the Risk Register

These are to:

- Identify key risks to the achievement of the Fund's objectives and to the Fund's day to day operations;
- Consider the risks identified;
- Assess the significance of the risks.

2. Risk assessment

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

- The likelihood and impact of the risk materialising without any mitigating controls being applied – 'the gross risk'.
- The likelihood and impact of the risk materialising with mitigating controls being applied – 'the residual risk'.
- Risks are evaluated on a sliding scale of 1 – 4 with the highest value being the most likely to occur/ most severe impact.
- The product of the likelihood and impact scores is the risk score:

Likelihood	**4**	**4 – medium/ low**	**8- medium/ high**	**12 - high**	**16 – high**
	3	**3 – medium/ low**	**6 – medium/ high**	**9 – medium/ high**	**12 – high**
	2	**2 – low**	**4 – medium/ low**	**6 – medium/ high**	**8 – medium/ high**
	1	**1 – low**	**2 - low**	**3 – medium/ low**	**4 – medium/ low**
		1	**2**	**3**	**4**
	Impact				

- The register below seeks to assess specific risks and introduce a measure of consistency into the risk assessment process. The risk scores relating to residual risks can then be prioritised.
- Planned actions, timescales, review dates, and direction of travel are noted for each risk, alongside the 'risk owner' responsible for managing it.
- The thick black line indicates a proposed 'risk appetite' or tolerable level, to indicate an aspiration for acceptable risks to be less than 'medium/ high'.

3. Objectives of the Pension Fund

These are to:

- enable employer contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies, whilst achieving and maintaining fund solvency, which should be assessed in light of the risk profile of the fund and the risk appetite of the administering authority and employers alike;

- manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due; and

- seek returns on investment within reasonable risk parameters.

4. Investment objectives of the Pension Fund

The Fund has two objectives in terms of its investment activities:

- To ensure that resources are available to meet the Fund's liabilities through achieving investment performance at least in line with actuarial assumptions.

- To achieve full funding (i.e. no funding deficit) over a period no longer than the current recovery period.

Lancashire County Pension Fund Risk Register – draft [March 2014]

APPENDIX A

Ref	Area	Risk	Cause	Impact	Gross Risk				Mitigation in place	Residual Risk				Planned Action	Date for completion	Review Date	Direction of travel	Owner
					Impact	Likelihood	Score	Risk Level		Impact	Likelihood	Score	Risk Level					
I001	Investment and funding risk	Asset / liability mismatch	Assets insufficient to fund liabilities	Inability to make benefit payments, meaning cash injections required from employers	4	2	8	M/H	Increasing focus on liability management, new investment strategy, diversified portfolio	4	1	4	M/L	Introduction of new focus on liability management.	On-going	June 2014	→	Chief Investment Officer
I002	Investment and funding risk	Inflation risk	Increases in commodity prices push up the level of inflation	Inflation increases pension payments but assets do not grow at required level	3	1	3	M/L	Hold some index linked assets	3	1	3	M/L	Inclusion of assets which counter inflation Monitor inflation position	On-going	June 2014	■	Chief Investment Officer
I003	Investment and funding risk	Concentration of assets	Over reliance of assets in one particular area	A significant allocation in a particular type asset will lead to an over exposure in that area and therefore vulnerability to significant changes.	2	2	4	M/L	New investment strategy is moving away from a large investment in equities. Amount of the fund in particular assets in governed by the pension fund regulations. Monthly monitoring of asset allocations by Investment Panel.	2	1	2	L	Implementation of new investment strategy.	On-going	June 2014	→	Chief Investment Officer
I004	Investment and funding risk	Falling share prices and therefore asset value	Actions of companies in who the pension fund invests (fraud, poor corporate governance)	Falling share prices and therefore a decrease in the assets held by the fund.	3	4	12	H	Investment portfolio is diverse in order to minimise such risks. Member of LAPFF and PIRC to promote engagement.	3	3	9	M/H	Continual monitoring and membership of LAPFF / PIRC. Equity strategy combining defensive and growth holdings.	On-going	June 2014	→	Chief Investment Officer
I005	Investment and funding risk	Under performance by fund managers	Fund managers not meeting required returns	Returns achieved lower than those anticipated in funding strategy leading to a greater funding gap	3	3	9	M/H	Mixture of active and passive managers, monitoring of investment manager performance, new investment strategy moving to a greater reliance on the internal team.	3	2	6	M/H	Implementation of new investment strategy.	On-going	June 2014	→	Chief Investment Officer
I006	Investment and funding risk	Liability risk: Discount rate	Market conditions between valuation dates produces a lower discount rate than expected by the actuary	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	4	4	16	H	Increasing focus on liability management, new investment strategy, diversified portfolio	4	4	16	H	Introduction of new focus on liability management. Key requirement to implement mitigating actions within next 6 months.	On-going	June 2014	■	Chief Investment Officer
I007	Investment and funding risk	Liability risk: Inflation rate	Assumed inflation rate within liability valuation applied to future pension increases and salary rises is lower than actual rate	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	4	4	16	H	Increasing focus on liability management, new investment strategy, diversified portfolio	4	4	16	H	Introduction of new focus on liability management. Key requirement to implement mitigating actions within next 12 months.	On-going	June 2014	■	Chief Investment Officer

Lancashire County Pension Fund Risk Register – draft [March 2014]

APPENDIX A

Ref	Area	Risk	Cause	Impact	Gross Risk				Mitigation in place	Residual Risk				Planned Action	Date for completion	Review Date	Direction of travel	Owner
					Impact	Likelihood	Score	Risk Level		Impact	Likelihood	Score	Risk Level					
I008	Investment and funding risk	Liability risk: Salary increase	Salary increases higher than expected (and maybe linked to inflation expectations)	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	4	2	8	M/ H	Provision for employers to top-up contributions to offset the increasing liabilities.	3	2	6	M/ H		On-going	June 2014	→	Chief Investment Officer
I009	Investment and funding risk	Liability risk: Longevity	The assumptions of future life expectancy and improvements in life expectancy may be lower than actual. Members may live longer and benefits may be paid for longer	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	4	4	16	H		4	4	16	H	Introduction of new focus on liability management, and 'insurance' arrangements.	On-going	June 2014		Chief Investment Officer
I010	Investment and funding risk	Liability risk: Early retirement/ ill-health retirement	Members retiring earlier than normal retirement age with no reduction in benefit will require employers to make greater contributions	The estimated value of liabilities will be higher than expected and therefore assets insufficient to fund them	4	2	8	M/ H	Provision for employers to top-up contributions to offset the increasing liabilities.	3	2	6	M/ H		On-going	June 2014	→	Chief Investment Officer
I011	Investment and funding risk	Liability risk: Diversification	Diversification of asset portfolio less than expected	Assets move in unpredictable directions, potentially increasing the funding gap between assets and liabilities	4	4	16	H	Increasing focus on liability management, new investment strategy, diversified portfolio	4	3	12	H		On-going	June 2014	→	Chief Investment Officer
I012	Investment and funding risk	Liability risk: LGPS regulations	Pension benefits are governed by statute, and any changes will impact on the fund's liabilities causing them to either increase or decrease	Liabilities are affected by statutory changes to LGPS	4	4	16	H	Increasing focus on liability management, new investment strategy, diversified portfolio. Lobbying of Government.	4	3	12	H		On-going	June 2014	→	Chief Investment Officer
I0013	Investment and funding risk	Custody risk	Custodian does not adequately meet the requirements of their contract	Problems with custodian leading to missed dividends or corporate actions.	2	2	4	M/L	Subscribe to services of Thomas Murray as custodian monitor.	2	1	2	L	Continued monitoring of custodian services	On-going	June 2014	→	Head of Investment Compliance
I014	Investment and funding risk	Investment returns below peer groups	Investment managers do not meet the required returns	Reputational risk, increasing gap between assets and liabilities	2	2	4	M/L	Regular monitoring and review	2	1	2	L	Increasing emphasis on internal management of funds	On-going	June 2014	→	Chief Investment Officer
I015	Investment and funding risk	Missed investment opportunities	Lack of awareness or slow decision making	Missed investment opportunities could result in reduced returns for the fund	2	3	6	M/H	Maintain a good relationship with investment managers and build strength in the internal team. Awareness of timetables and protocols	2	2	4	M/L	Monitoring of investment deadlines in relation to internal deadlines and workloads	On-going	June 2014	→	Investment Management Team

Lancashire County Pension Fund Risk Register – draft [March 2014]

APPENDIX A

Ref	Area	Risk	Cause	Impact	Gross Risk				Mitigation in place	Residual Risk				Planned Action	Date for completion	Review Date	Direction of travel	Owner
					Impact	Likelihood	Score	Risk Level		Impact	Likelihood	Score	Risk Level					
I016	Investment and funding risk	Mismatch of funding plan and investment strategy	Incorrect assumptions made regarding assets and liabilities	Incorrect contribution rates could be set	3	2	6	M/H	Funding strategy and investment strategy to be linked to triennial reviews	3	1	3	M/L	Contribution rates to be reviewed following the results of recent triennial review	On-going	June 2014	→	Chief Investment Officer
I017	Investment and funding risk	Insufficient cash available to meet requirements	Poor management of liquidity	If liquidity is not managed, assets may need to be sold quickly meaning the best price is not achieved	2	3	6	M/H	Implement effective cash management strategies	2	2	4	M/L	Cash position is monitoring on a regular basis by the accounting team. Weekly meetings are held with Investment management Team so cash requirements are known	On-going	June 2014	→	Head of Financial Accounting
I018	Investment and funding risk	Transition risk of the new investment strategy	Unforeseen events	Incurring unexpected costs while moving the assets	2	3	6	M/H	Specialist transition manager has been appointed to oversee this process on behalf of the pension fund.	2	2	4	M/L	Transition position is monitored during the Investment Management Team weekly meeting	On-going	June 2014	→	Head of Public Markets
E001	Employer Risk	Inability of an employer to meet its contribution requirements due to legislative or actuarial changes.	Increased level of contributions required from employer	Overall fund faces increasing liabilities	2	3	6	M/H	Monitor risk picture of the employers, particularly with reference to the size of their liability	2	3	6	M/H	Review financial standing of the employers in the scheme with reference to the size of their liabilities.	On-going	June 2014	■	Deputy County Treasurer
E002	Employer Risk	Employer ceasing to exist	Employer closes	If there is insufficient funding, bond of guarantee in place any shortfall will be attributed to the whole fund, thereby increasing the level of liabilities	2	3	6	M/H	Monitor employers risk profiles and ensure bonds are sufficient	2	2	4	M/L	Review financial standing of the employers in the scheme with reference to the size of their liabilities, anticipate employers with potential financial difficulties and discuss with them potential future options	On-going	June 2014	→	Deputy County Treasurer
S001	Skill and Resource risk	Key person risk	Someone leaving the organisation and only a limited market from which to seek their replacement	Knowledge gap which it may be difficult to fill	2	3	6	M/H	Maintain a system of staff cover; succession planning and development	2	2	4	M/L	Increase breadth of expertise throughout internal team. Maintain relationships with external providers.	On-going	June 2014	→	Chief Investment Officer
S002	Skill and Resource risk	Lack of expertise / resources of officers involved in the Pension Fund	Insufficient training or continuous development	Either inappropriate staffing or insufficient resources in a particular area meaning that the fund cannot be managed or administered properly and mistakes are made.	3	2	6	M/H	Regular performance appraisals and training plans in place. On the job training.	3	1	3	M/L	Attendance at regular conferences and courses. On the job training.	On-going	June 2014	→	Chief Investment Officer
S003	Skill and Resource risk	Insufficient knowledge of pension fund committee members	Insufficient training or continuous development	Inappropriate decisions taken at committee meetings or inability to make decisions through lack of understanding	4	2	8	M/H	Implement training for new members. Have an on-going training requirement for members and officers to ensure knowledge remains up to date. Mixture of in-house and external sessions. Officer expert advice.	3	2	6	M/H	Implementation of training programme for members following their appointment to the Pension Fund Committee. Ongoing assessment of any development needs. Use of KSF toolkit.	On-going	June 2014	→	Head of Investment Compliance

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					Impact	Likelihood	Score	Risk Level		Impact	Likelihood	Score	Risk Level					
S004	Skill and Resource risk	Insufficient external expertise	Failure to employ specialist advisers when their skills are required	Under performance of fund	3	2	6	M/H	Employ specialists where appropriate from consultancy bench and develop in-house expertise	3	1	3	M/L	Increasing moves to develop internal expertise. Refresh consultant bench to ensure breadth of expertise.	On-going	June 2014	→	Chief Investment Officer
S005	Skill and Resource risk	Inappropriate decision making	Production of poor or inappropriate performance management information	Incorrect decisions being taken due to the reliance on this information	4	2	8	M/H	Use of independent Custodian. Implement regular monitoring in an agreed format. Regular monitoring of performance information and on-line access to NT Passport system.	4	1	4	M/L	Decision making protocols documented are in place to ensure each decision is adequately considered and approved.	On-going	June 2014	→	Chief Investment Officer

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					Impact	Likelihood	Score	Risk Level		Impact	Likelihood	Score	Risk Level					
G001	Governance and compliance risk	Non compliance with LGPS regulations	Lack of technical expertise / staffing to research any regulation changes	Non compliance with legislation change could result in penalties or sanctions leading to financial loss	3	3	9	M/H	Monitor legislative changes, engage in consultations, attend pension update briefings / courses.	3	2	6	M/H	Attendance at conference and regular review of work practices	On-going	June 2014	→	Head of Investment Compliance
G002	Governance and compliance risk	Non compliance with investment policies	Lack of understanding of investment policies	Non compliance with investment policies could increase the risk profile of the fund.	3	3	9	M/H	Periodic monitoring of investment types against regulations. Individual investments checked in advance of commitment as part of internal Due diligence.	3	2	6	M/H	Compliance monitoring to be incorporated into monthly performance dashboard.	On-going	June 2014	→	Head of Investment Compliance
G003	Governance and compliance risk	Production of incorrect financial statements	Production of misleading information and misleading stakeholders	Misunderstanding or wrong decisions	2	2	4	M/L	Review and sign off process in place.	2	1	2	L	Implementation of closure timetable, which includes regular management reviews of progress and figures	On-going	June 2014	→	Head of Financial Accounting
G004	Governance and compliance risk	Conflict of interest	Officers or members fail to declare a conflict of interest leading to decisions that are not in the best interest of the fund	Inappropriate decisions taken	2	2	4	M/L	Training on what constitutes a conflict and ensuring register of interests/ gift and hospitality entries are made where appropriate.	2	1	2	L	Officers and Pension Fund Committee members encouraged to declare all applicable items on the register.	On-going	June 2014	→	Chief Investment Officer
G005	Governance and compliance risk	Failure to minute meetings correctly	Important decisions are not documented and then there is no record of them when evidence of the decision is required.	Unable to prove that a decision has been taken	2	2	4	M/L	All meetings to be minuted and agreed by members	2	1	2	L	All meetings containing key investment decisions are minuted by Democratic Services	On-going	June 2014	→	Principal Committee Support Officer
G006	Governance and compliance risk	Failure to implement an proper monitoring system	Performance of the fund cannot be monitored over time	Incorrect decisions are taken	3	2	6	M/L	Implement a regular monitoring system	3	1	3	M/L	Performance of the fund is monitored on a monthly basis and reported to Investment Panel and to the Pension Fund Committee at its meetings	On-going	June 2014	→	Head of Investment Compliance
G007	Governance and compliance risk	Information loss (intellectual property and confidential information)	Sensitive information could be lost damaging the reputation of the fund and putting the fund members at risk	Damaged reputation / litigation risk	3	3	9	M/H	Ensure confidential information is secure	3	2	6	M/H	Information asset audit undertaken and any resulting actions carried out. Confidential information is held in secure filing cabinets or Deed Room. Clear desk policy.	On-going	June 2014	→	Head of Investment Compliance/ Chief Investment Officer
G008	Governance and compliance risk	Information governance	Loss of information which means that the fund is unable to operate	Unable to undertake day to day functions	3	2	6	M/H	Back up of ICT network. Use of Northern Trust web-based Passport system.	3	1	3	M/L	Back up of ICT network and continued use of NT Passport.	On-going	June 2014	→	Head of Investment Compliance
G009	Governance and compliance risk	Non-existent assets	The risk that assets purchased by the pension fund do not exist, or fund managers are not bona fide.	Misrepresentation of assets held. Reputational damage.	4	3	12	H	Due diligence undertaken as part of investment review process either by Fund officers or investment consultants.	4	2	8	M/H	Robust policy of meeting managers in situ in advance of commitment. Physical inspection of assets by Fund.	On-going	June 2014	→	Chief Investment Officer

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APPENDIX A

Ref	Area	Risk	Cause	Impact	Gross Risk				Mitigation in place	Residual Risk				Planned Action	Date for completion	Review Date	Direction of travel	Owner
					Impact	Likelihood	Score	Risk Level		Impact	Likelihood	Score	Risk Level					
R001	Reputational risk	Actions damage the perception of the fund	Reputation of the fund will be damaged which may impact on participation rates and investment strategies		3	3	9	M/H	Good governance, open communication. Use of PIRC/ LAPFF to engage with shareholder companies to encourage good governance.	3	2	6	M/H	Employ good corporate governance systems within the organisation. Stronger ESG policy.	On-going	June 2014	→	Chief Investment Officer/ Head of Investment Compliance
A001	Administration risk	Failure to process pension payments and lump sums on time	Unavailability of IT / staff, or errors	Maintenance of IT, staff cover and training	2	2	4	M/L	Testing of system including audit	2	1	2	L	Ensure adequate back-up procedures are in place	On-going	June 2014	→	Head of Your Pension Service
A002	Administration risk	Failure to collect contributions from employers and employees	Unavailability of IT / staff, or errors or poor communication	Maintenance of IT, staff cover and training	3	2	6	M/H	Robust back-up systems in place	2	1	3	L	Robust back-up systems in place	On-going	June 2014	→	Head of Your Pension Service
A003	Administration risk	Inability to provide service due to loss of facilities	Fire, flood etc	Unable to provide service	4	2	8	M/H	Business continuity	4	1	4	M/L	Testing of business continuity plans.	On-going	June 2014	→	Head of Your Pension Service
A004	Administration risk	Loss of funds through fraud	Fraud or misappropriation of funds	Financial loss to fund	4	2	8	M/H	Internal controls – separation of duties. Internal and external audit reviews.	2	1	2	L		On-going	June 2014	→	Head of Your Pension Service
A005	Administration risk	Failure to hold personal data securely	Poor procedures for data transfer, data retention and back up	Data is lost or compromised	4	3	12	H	Internal ICT controls. Information governance awareness.	4	1	4	M/L	Further work to improve the security of data interchange with employers through improvements in technology	On-going	June 2014	→	Head of Your Pension Service
A006	Administration risk	Failure to keep records up to date	Poor or non-existent notification of changes	Incorrect records held and therefore incorrect pensions paid	3	3	9	M/H	Documented internal controls. Robust training. Regular monitoring.	2	2	4	M/L		On-going	June 2014	→	Head of Your Pension Service

Agenda Item 14

Pension Fund Committee
Meeting to be held on 27 March 2014

Electoral Division affected:
'All'

Shareholder Voting, Engagement, and Fiduciary Duty
(Appendices 'A' and 'B' refer)

Contact for further information:
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Executive Summary

In accordance with its policies on promoting corporate social responsibility in the businesses in which it invest the Fund works through Pensions and Investment Research Consultants Ltd (PIRC) as its Governance Adviser and the Local Authority Pension Fund Forum (LAPFF) to both ensure that shares are voted in accordance with sound governance principles and to seek to influence companies' behaviour.

This report provides the latest quarterly update for the Committee on the work undertaken on the Fund's behalf by PIRC and the engagement activity undertaken by LAPFF.

The attached report from PIRC (Appendix A) covers the period 1 October to 31 December 2013. The Fund has voted on 274 occasions and has opposed or abstained in 34% of votes. PIRC recommends not supporting resolutions where it does not believe best governance practice is being applied. PIRC's focus has been on promoting independent representation on company boards, separating the roles of CEO and Chairman and ensuring remuneration proposals are aligned with shareholders' interests.

Details of the holdings of the Pension Fund in relation to the meetings held in this period are also given to provide more contextual information regarding the geographical and sector spread of the shareholder interests.

The attached engagement report from LAPFF (Appendix B) also covers the period 1 October to 31 December 2013.

Details of potential class actions in relation to companies in which Lancashire County Pension Fund owns, or has owned shares is also set out in the report.

Recommendation

The Committee is asked to note the report.

Lancashire County Council

Background and Advice

1. Shareholder Voting and Governance

1.1 PIRC, acts as the Fund's proxy and casts the Fund's votes at shareholder meetings. PIRC are instructed to vote in accordance with their guidelines unless the Fund instructs an exception. PIRC analyses investee companies and produces publically available voting recommendations to encourage companies to adhere to high standards of governance and social responsibility. The analysis includes a review of the adequacy of environmental and employment policies and the disclosure of quantifiable environmental reporting. PIRC is also an active supporter of the Stewardship Code, a code of practice published by the Financial Reporting Council with the aim of enhancing the quality of engagement between institutional investors and companies.

1.2 There may be occasions when the Fund wishes to cast a vote at a shareholder meeting in a way which does not accord with PIRC's recommendations. For example, an investment manager might request the Fund to vote in a particular way to support or oppose a corporate action. Such requests would be considered by the Fund on a case by case basis and PIRC instructed to cast the Fund's vote accordingly.

1.3 PIRC also lobbies actively on behalf of its investing clients as well as providing them with detailed support. It works closely with NAPF (the National Association of Pension Funds) and LAPFF (the forum of Local Authority Pension Funds). The Lancashire County Pension Fund is a member of both these organisations.

1.4 PIRC's quarterly report to 31 December 2013 is presented at Appendix A. This report not only provides details of the votes cast on behalf of the Fund but also provides a commentary on events during the period relevant to environmental social and governance issues.

1.5 In addition PIRC produces a detailed document which is reviewed by the Fund's officers, which sets out the circumstances and reasoning for every resolution opposed, abstained or withheld. This document is available on request.

1.6 The Fund's voting record using PIRC as its proxy for the three months ended 31 December 2013 is summarised below:

GEOGRAPHIC VOTING OVERVIEW

Geographic Region	Meeting	Resolutions	For	Oppose	Abstain	Withheld	Non-Voting
SOUTH AND CENTRAL AMERICA	0	0	0	0	0	0	0
REST OF THE WORLD	13	75	35	20	11	0	9
ASIA	3	22	11	11	0	0	0
NORTH AMERICA	6	68	38	22	1	7	0
UK	4	74	61	5	8	0	0
EU	2	30	15	9	3	0	3
JAPAN	0	0	0	0	0	0	0

ANALYSIS OF UK ALLSHARE VOTING RECOMMENDATIONS

Resolution Type	For		Abstain		Oppose		Total
	No.	%	No.	%	No.	%	
Annual Reports	3	75.0	1	25.0	0	0.0	4
Remuneration Reports	0	0.0	2	50.0	2	50.0	4
Articles of Association	0		0		0		0
Auditors Appointment	1	25.0	3	75.0	0	0.0	4
Directors	31	91.18	1	2.94	2	5.88	34
Dividend	4	100.0	0	0.0	0	0.0	4
Executive Pay Scheme	0	0.0	0	0.0	1	100.0	1

1.7 The Fund was party to 274 resolutions during this period, of which 59% resulted in positive votes for shareholder resolutions and 34% were opposed or an abstention given. Voting abstention is regularly used by institutional investors as a way of signalling a negative view on a proposal without active opposition. In addition, within certain foreign jurisdictions, shareholders either vote for a resolution or not at all, opposition to these votes is described as vote withheld. These totalled 7 within the period, just under 3%. The remaining agenda items required no vote.

1.8 Details of the votes made on Lancashire's behalf during the period are set out in the following table, and gives the company name, the date of the meeting, the meeting type (typically Annual General Meeting (AGM) or Extraordinary General Meeting (EGM)), the country of incorporation, primary market sector, the value of Lancashire's holding in each company, and the voting details.

Lancashire County Pension Fund voting details Q4 2013

Company	Meeting Date	Type	Country	Sector	Lancashire holding as at 31 December 2013 (£)	Resolution Count	For	Oppose	Abstain	Withhold	Withdrawn	Non-Voting
PROSPECT CAPITAL CORP	06/12/2013	AGM	United States	Capital Markets	1,643,455	4	2	1	0	1	0	0
TATTS GROUP LTD	31/10/2013	AGM	Australia	Capital Markets	1,766,924	7	5	0	1	0	0	1
WESFARMERS LTD	07/11/2013	AGM	Australia	Food and Staples Retailing	2,325,556	10	6	3	0	0	0	1
CLOROX CO.	20/11/2013	AGM	United States	Household Products	2,458,665	13	8	5	0	0	0	0
SONIC HEALTHCARE LTD	21/11/2013	AGM	Australia	Healthcare Providers and Services	1,990,792	4	2	0	2	0	0	0
BRAMBLES LTD	03/12/2013	EGM	Australia	Commercial Services & Supplies	6,713,463	2	1	1	0	0	0	0
ASSOCIATED BRITISH FOODS PLC	06/12/2013	AGM	United Kingdom	Food Products	2,740,918	17	13	3	1	0	0	0
CARSALES.COM LTD	25/10/2013	AGM	Australia	Internet Software & Services	2,065,375	5	1	2	1	0	0	1
SYDNEY AIRPORT	22/11/2013	EGM	Australia	Transportation Infrastructure	1,746,803	6	0	0	6	0	0	0
FUGRO NV	27/11/2013	EGM	Netherlands	Energy Equipment & Services	6,627,163	5	1	1	0	0	0	3
SMITHS GROUP PLC	19/11/2013	AGM	United Kingdom	Industrial Conglomerates	3,857,472	19	17	0	2	0	0	0
PERNOD RICARD SA	06/11/2013	AGM	France	Beverages	3,338,741	25	14	8	3	0	0	0
WOLSELEY PLC	26/11/2013	AGM	United Kingdom	Trading Companies & Distributors	10,371,517	19	15	1	3	0	0	0
TELSTRA CORP LTD	15/10/2013	AGM	Australia	Diversified Telecommunication Services	2,616,633	6	1	2	1	0	0	2
MINDRAY MEDICAL INTL	17/12/2013	AGM	China	Health Care Equipment & Supplies	8,566,932	3	1	2	0	0	0	0
CSL LTD	16/10/2013	AGM	Australia	Biotechnology	2,867,307	6	2	3	0	0	0	1
SHANDONG WEIGAO GP MED POYL	15/11/2013	EGM	China	Health Care Equipment & Supplies	4,587,295	6	2	4	0	0	0	0
ANZ-AUSTRALIA & NEW ZEALD BK	18/12/2013	AGM	Australia	Commercial Banks	3,414,535	10	6	3	0	0	0	1
WOOLWORTHS LTD	26/11/2013	AGM	Australia	Food & Staples Retailing	2,395,815	7	2	3	1	0	0	1
COMMONWEALTH BANK AUSTRALIA	08/11/2013	AGM	Australia	Commercial Banks	3,906,216	8	5	2	0	0	0	1
BRAMBLES LTD	03/12/2013	COURT	Australia	Commercial Services & Supplies	6,713,463	1	1	0	0	0	0	0
BRAMBLES LTD	22/10/2013	AGM	Australia	Commercial Services & Supplies	6,713,463	5	3	1	0	0	0	1
SINGAPORE PRESS HOLDINGS LTD	29/11/2013	AGM	Singapore	Media	1,885,461	13	8	5	0	0	0	0
INCITEC PIVOT LTD	19/12/2013	AGM	Australia	Chemicals	7,381,430	3	1	2	0	0	0	0
PROCTER & GAMBLE CO	08/10/2013	AGM	United States	Household Products	9,570,031	15	9	6	0	0	0	0
MICROSOFT CORP.	19/11/2013	AGM	United States	Software	9,493,830	12	6	6	0	0	0	0
ORACLE CORP.	31/10/2013	AGM	United States	Software	25,738,833	19	10	2	1	6	0	0
HAYS PLC	13/11/2013	AGM	United Kingdom	Professional Services	4,653,805	19	16	1	2	0	0	0
MYRIAD GENETICS INC	05/12/2013	AGM	United States	Biotechnology	2,415,629	5	3	2	0	0	0	0
						274	**161**	**69**	**24**	**7**	**0**	**13**

2. Shareholder Engagement through LAPFF

2.1 Lancashire County Pension Fund is also a member of the Local Authority Pension Fund Forum (LAPFF), which exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest.

2.2 Members of the Committee may be interested to note the attached engagement report from LAPFF (Appendix B) which covers the period 1 October to 31 December 2013.

2.3 It sets out details of their activities in influencing governance, employment standards, reputational risk, climate change, finance and accounting, and Board composition, and provides a slightly different and wider perspective than the PIRC report.

3. Class Actions

United States

3.1 The Fund has appointed Barrack, Rodos and Bacine (BR&B) to provide a US class actions monitoring service with the aim of ensuring that the Lancashire County Pension Fund receives all monies due to the Fund by filing its proof of claim from these cases. This service is at no cost to the Fund.

3.2 BRB will identify class actions where the Fund has a potential loss arising from an alleged fraud or a securities law violation. This is achieved by the BR&B 'BEAMS' monitoring system which follows each securities case from the beginning to the end by ensuring its filing of the proof of claim so that the Fund may receive its payment.

3.3 Occasionally the Fund may be asked to participate in a class action, and/ or to apply to become the lead or co-lead plaintiff, but under US law any shareholder subject to such a loss will be automatically entered into and benefit from a class action without having to file an individual claim.

3.4 Details of current potential US cases as at 31 December 2013 are set out below:

Company Name	Effective Class Period Begin	Effective Class Period End	Case Status	Potential loss incurred ($'000)
Medtronic, Inc.	08/12/10	03/08/11	ACTIVE	27.71
CenturyLink, Inc.	08/08/12	14/02/13	ACTIVE	521.63
Barrick Gold Corp.	07/05/09	23/05/13	ACTIVE	411.36
Intuitive Surgical, Inc.	19/10/11	18/04/13	ACTIVE	251.54
ITT Educational Services, Inc.	24/04/08	25/02/13	ACTIVE	760.06

United Kingdom

3.5 Unlike class actions within the US jurisdiction, where all relevant recipients benefit from a class action when filed, class actions within the UK require investors to file their actions individually in order to potentially benefit from a successful class action. Such actions are therefore much less prevalent.

3.6 The Committee will recall a current class action relating to the alleged actions of Royal Bank of Scotland (RBS) where, it is argued, investors suffered losses in respect of a subsequent Rights Issue in 2008.

3.7 The deadline for filing a claim in relation to the RBS action remains April 2014. The Urgent Business Procedure on behalf of the Pension Fund Committee is being used to enable the County Council's participation in the class action. Details of this approval are included as a separate report to this meeting of the Pension Fund Committee.

3.8 Confirmation has now been received from the UK lawyers arranging the class action that Lancashire County Pension Fund will now be included in the next wave of claimants to be added to the claim against RBS.

4. Fiduciary duty update

4.1 At the 29 November 2013 meeting of the Committee, and following a discussion around the issue of ethical investment and the Fund’s fiduciary duty, the Committee welcomed the prospect of greater clarity over fiduciary duty and it was agreed that the Fund would review the position when the outcome of the Law Commission’s review was published. The Law Commission have indicated that they expect to report in June 2014.

4.2 Since then, Full Council has passed a motion covering this area at its meeting on 12 December 2013. The progress made to date in responding to the requirements of the Council Motion are set out in a separate report to this meeting of the Pension Fund Committee.

Consultations

N/A

Implications:

It is a key component of good governance that the Fund is an engaged and responsible investor complying with the Stewardship Code.

Well run responsible companies are more likely to be successful and less likely to suffer from unexpected scandals.

Risk management

The promotion of good responsible corporate governance in the companies the Fund is invested in reduces the risk of unexpected losses arising as a result of poor over-sight and lack of independence.

Involvement in a non-US class action may result in losses incurred being recovered for the Fund, but should a case be lost then the Fund may incur related costs which may not be known with certainty at the time of filing. Applying for lead plaintiff status in the US may incur significant officer time and resources in bringing a potential case to fruition.

Should the claimants in the litigation against RBS fail, then it is possible that LCPF faces having to make a contribution towards RBS costs notwithstanding the insurance in place. The amount of any shortfall following an insurance settlement and the LCPF contribution thereto is impossible to quantify at this stage.

Furthermore, if successful the LCPF will be required to hand over a proportion of any sum recovered to the funder and claimant solicitors.

Local Government (Access to Information) Act 1985
List of Background Papers

N/A

PIRC

LANCASHIRE COUNTY COUNCIL QUARTERLY VOTING REPORT Q4 2013

OVERVIEW

1. The Pension Fund received voting recommendations for **274** resolutions at **29** meeting meetings in the quarter ended **2013-12-31**.
2. The Pension Fund supported **161** of the resolution (**58.76%**).
3. The Pension Fund voted against on **69** occasions (**25.18%**).
4. The Pension Fund abstained on **24** occasions (**8.76%**).
5. There were **13** non-voting agenda items (**4.74%**).
6. There were **7** withheld agenda items (**2.55%**).

TABLE 1: GEOGRAPHIC VOTING OVERVIEW

Geographic Region	Meeting	Resolutions	For	Oppose	Abstain	Withheld	Say When on Pay	Non-Voting
SOUTH AND CENTRAL AMERICA	0	0	0	0	0	0	0	0
REST OF THE WORLD	13	75	35	20	11	0	0	9
ASIA	3	22	11	11	0	0	0	0
NORTH AMERICA	6	68	38	22	1	7	0	0
UK	4	74	61	5	8	0	0	0
EU	2	30	15	9	3	0	0	3
JAPAN	0	0	0	0	0	0	0	0

TABLE 2: ANALYSIS OF UK ALLSHARE VOTING RECOMMENDATIONS

Resolution Type	For	Percentage %	Abstain	Percentage %	Oppose	Percentage %	Total
Annual Reports	3	75.0	1	25.0	0	0.0	4
Remuneration Reports	0	0.0	2	50.0	2	50.0	4
Articles of Association	0		0		0		0
Auditors Appointment	1	25.0	3	75.0	0	0.0	4
Directors	31	91.18	1	2.94	2	5.88	34
Dividend	4	100.0	0	0.0	0	0.0	4
Executive Pay Scheme	0	0.0	0	0.0	1	100.0	1

TABLE 3: MEETINGS VOTE / NOT VOTED IN THE QUARTER

Company	Meeting Date	Type	Date Voted	Comment
PROCTER & GAMBLE CO	2013-10-08	AGM	2013-09-25	Voted
TELSTRA CORP LTD	2013-10-15	AGM	2013-09-30	Voted
CSL LTD	2013-10-16	AGM	2013-09-30	Voted
BRAMBLES LTD	2013-10-22	AGM	2013-10-10	Voted
CARSALES.COM LTD	2013-10-25	AGM	2013-10-14	Voted
ORACLE CORP.	2013-10-31	AGM	2013-10-22	Voted
TATTS GROUP LTD	2013-10-31	AGM	2013-10-16	Voted
PERNOD RICARD SA	2013-11-06	AGM	2013-10-21	Voted
WESFARMERS LTD	2013-11-07	AGM	2013-10-22	Voted
COMMONWEALTH BANK AUSTRALIA	2013-11-08	AGM	2013-10-24	Voted
HAYS PLC	2013-11-13	AGM	2013-11-04	Voted
SHANDONG WEIGAO GP MED POYL	2013-11-15	EGM	2013-10-30	Voted
MICROSOFT CORP.	2013-11-19	AGM	2013-11-11	Voted
SMITHS GROUP PLC	2013-11-19	AGM	2013-11-08	Voted
CLOROX CO.	2013-11-20	AGM	2013-11-05	Voted
SONIC HEALTHCARE LTD	2013-11-21	AGM	2013-11-08	Voted
SYDNEY AIRPORT	2013-11-22	EGM	2013-11-08	Voted
WOLSELEY PLC	2013-11-26	AGM	2013-11-18	Voted
WOOLWORTHS LTD	2013-11-26	AGM	2013-11-12	Voted
FUGRO NV	2013-11-27	EGM	2013-11-14	Voted

SINGAPORE PRESS HOLDINGS LTD	2013-11-29	AGM	2013-11-19	Voted
BRAMBLES LTD	2013-12-03	COURT	2013-11-19	Voted
BRAMBLES LTD	2013-12-03	EGM	2013-11-19	Voted
MYRIAD GENETICS INC	2013-12-05	AGM	2013-11-20	Voted
ASSOCIATED BRITISH FOODS PLC	2013-12-06	AGM	2013-11-22	Voted
PROSPECT CAPITAL CORP	2013-12-06	AGM	2013-11-20	Voted
MINDRAY MEDICAL INTL	2013-12-17	AGM	Not Voted	No shares to vote.
ANZ-AUSTRALIA & NEW ZEALD BK	2013-12-18	AGM	2013-12-11	Voted
INCITEC PIVOT LTD	2013-12-19	AGM	2013-12-10	Voted

TABLE 4: SIGNIFICANT FOR VOTES

GEOGRAPHICAL LOCATION			
SOUTH AND CENTRAL AMERICA			
Meetings	Count All For	AGM	EGM
0	0	0	0
REST OF THE WORLD			
Meetings	Count All For	AGM	EGM
13	0	0	0
ASIA			
Meetings	Count All For	AGM	EGM
3	0	0	0
NORTH AMERICA			

Meetings	Count All For	AGM	EGM
6	0	0	0
UK			
Meetings	Count All For	AGM	EGM
4	0	0	0
EU			
Meetings	Count All For	AGM	EGM
2	0	0	0
JAPAN			
Meetings	Count All For	AGM	EGM
0	0	0	0

CLIENT VOTE CHANGES
There were no vote changes during the quarter

VOTES REJECTED IN THE QUARTER AND EXPLANATION
PIRC was not notified of any vote rejections during the quarter.

UK Stories

<u>Audit Reforms</u>

FRC Response

The last Quarterly Report outlined proposals from Competition Commission to reform auditor selection and governance processes for FTSE 350 companies including rotation and reporting to shareholders as part of it Statutory Audit Services Market Investigation.
The Financial Reporting Council has responded to these proposals and posted only the letter it has sent to the Competition Commission addressing in turn various specifics raised by the Commission's statutory audit services market inquiry.

The FRC does not support or seeks amendments to many of the proposals and has undertaken to conduct a further consultation later this year around changes to the UK Corporate Governance Code. The response can be viewed at the FRC website. In respect of its proposed remedies, the Competition Commission is expected to publish a draft Order in late January 2014.

<u>Questioning shareholder primacy & stability of the financial system</u>

One of the interesting ideas in the Parliamentary Commission on Banking Standards (PCBS) report was that shareholder primacy should be removed at the banks. Now under consultation by BIS, the proposal is drawing out some interesting responses.

The proposal was included in the BIS consultation paper *Transparency & Trust*. The idea has already been panned by the Financial Reporting Council, (FRC) which argued that "If shareholder primacy is removed it may affect the ability of banks to attract future capital' and as PIRC previously noted the Institutional Investor Committee has gave the concept short thrift.

The idea was given a more positive welcome by the TUC, which probably senses the opportunity to have a discussion about other governance models where employees play a greater role. But possibly the most surprising response to the BIS consultation question on this issue came from the Institute of Directors who took what may be regarded as a slightly radical position. Although the IoD does not agree with amending company law, as proposed by the PCBS, it is sympathetic to the thrust of the proposal.

It said: 'We agree that the directors of systemically important financial institutions have wider responsibilities than simply promoting the interests of shareholders, even taking into account the nuances of the 'enlightened shareholder value' concept that is embedded in section 172 of the CA06… In an ideal world, systemically-important financial institutions (or other organisations that are "too big or important to fail") would adopt some other corporate legal framework in which directors' fiduciary duties were explicitly framed in terms of promoting broader social or stakeholder objectives, such as the stability of the financial system.'
So banks shouldn't be PLCs, and their directors should have "social or stakeholder objectives". That could be regarded as a major change to established governance principles, or even market based economic orthodoxy.

Appeals Court Extends Legal Advisers Duty of Care

This recent decision of the Appeals Court goes bears a closer look.
The delicate relationship between a company's officers and their non-executive directors was tested again in a decision arising from a dispute between Newcastle International Airports Ltd (NAIL) and their legal advisers Eversheds LLP.

The law firm was asked to give advice with regard to new service contracts for the company's two executive directors, the CEO and Finance Director/Company Secretary. The new contracts provided for bonus payments of £8m and altered covenants preventing both executives working for competing airports. The CEO was the chief company officer instructing Eversheds on preparation of the new contracts arising from deliberations of the Remuneration Committee.

Following the transactions that triggered bonus payments to the executives, disclosure of the signed contracts and attendant public controversy, NAIL subsequently pursued a claim for damages for alleged negligence by Eversheds.

NAIL contended that neither the Board nor the Remuneration Committee were aware of the full implications of the new service agreements when they were signed on behalf of the company.

The claim was originally dismissed by Proudman J of the UK High Court-Chancery Division in a judgment handed down in early December 2012, with costs against the appellant.

NAIL subsequently mounted an appeal. ICLR reports that the Court of Appeal (Appeals Court) decision in the matter Newcastle International Airport Ltd v Eversheds LLP [2013] EWCA Civ 1514 went in their favour.

The headnote reads: 'Where solicitors were retained by a company to draft new contracts between the company and its executive directors the solicitors breached their duty of care to the company by simply carrying out instructions given by the executive on behalf of the company. In the circumstances of the case, the court held that the solicitors' duty of care required them to give express, separate advice to the chair of the company's remuneration committee regarding the nature and effect of the changes made in the contracts.'

In his Appeals judgment, Lord Justice Rimer stated (paras. [80] and [81]): 'I readily accept that in a conventional case in which a company authorises one of its executives to instruct a solicitor in relation to a company matter, being one in which the executive has no personal interest conflicting with that of the company but can simply be regarded as a human organ of the company, there will ordinarily be no need for the solicitors to give advice as to the matter the subject of their instruction to anyone other than the executive. Advice to him will stand as advice to the company. That, however, was manifestly not this case'.

In effect, the Appeals Court upheld of the original decision, but reversed the view that there was no breach by Eversheds and in doing so expanded on the duty of care required by legal advisers particularly where the instructing officer of the company has an interest in the matter.
Separate advice directly to the Chair of the Remuneration Committee appears to be the crux in this particular circumstance.

A further indication of where overall responsibility lay appeared in the final line of the Appeals Court decision on the extent of the duty of care breach by Eversheds.

‘I have taken a different view from the judge as to the extent of Eversheds' duty of care, and would hold that, by failing to provide any explanatory memorandum to Ms Radcliffe, [Chair of the NAIL Remuneration Committee] they breached their retainer. For reasons given, however, I agree with the judge that such breach was not causative of substantial loss.’

‘Formally, I consider that the correct course would be to allow NIAL's appeal, set aside paragraph 1 of the judge's order by which she dismissed NIAL's claim and substitute for it an order that Eversheds must pay NIAL nominal damages of £2 for breach of retainer.’ A helpful reassertion of accountability by officers of a company to their elected directors.

Rising off-shore ownership of UK quoted stocks reflect underlying long term changes in domestic capital markets.

Non British shareholders now own more than half of the UK-quoted shares, raising questions about the current regime of company ownership.

A report by the Office for National Statistics (ONS) estimates that owners from the rest of the world hold 53.2 per cent of the value of UK stock. Ownership by overseas investors has increased substantially since 1963 and has now for the first time overtaken domestic shareholders. The ONS survey has estimated ordinary shares holdings in quoted companies in the UK by sector of beneficial ownership and found that UK individuals, who now once again represent the largest class of UK investors, merely held 10.7 per cent by value at the end of 2012.

After individuals, the next biggest UK shareholders are estimated to be unit trusts with 9.6 per cent holding, continuing strong growth seen in recent years. In contrast, insurance companies and pension funds have seen their holdings plummet over the years.

UK insurers only held 6.2 per cent at the end of 2012, which is significantly lower than the levels seen in recent years. Similarly, pension funds holding well over 30 per cent of UK stocks in the early 1990s, have seen their ownership shrink to only 4.7 per cent. The report suggests that the decline in UK holdings by institutional investors reflects their broadening of portfolios in search for higher returns and the spread of risk.

According to the ONS: “The large increase [of world ownership] since 1994 partly reflects the growth in international mergers and acquisitions, and the ease of overseas residents to invest in UK shares.” The ONS survey clearly shows that two of the biggest overseas share owners are unit trusts and other financial institutions, together holding 57 per cent of UK stocks that are foreign owned and that such investors are primarily looking for financial returns for their overseas clients.

The danger here is that they maybe less likely to take into account matters such as high standards of corporate governance or what is good for the British economy and society as a whole. For every CalPERS or Norges Bank there maybe several US mutual funds, whose views of executive pay are even more accommodating of corporate largesse than some of our domestic institutions.

Under a liberal capital market regime such investors should have the same rights as domestic investors, who might at least have a tendency to pursue long term investment strategies and ought to be more aligned with the interests of British society.

Concerns about the globalisation of ownership should not be simply dismissed as parochial. Such a profound shift in the nature of the ownership of British business, and what it means for our system of corporate governance, deserves proper debate.

Slow Progress on FTSE Gender Diversity

With Angela Ahrendts leaving Burberry as the company's chief executive, only two female FTSE 100 CEOs remain.

The news about Angela Ahrendts, CEO of Burberry, moving to Apple to become senior vice-president of its retail and online stores triggered a renewed debate in the UK about the progress towards greater gender diversity at the executive level of FTSE 100 companies. Ms. Ahrendts is one of only three remaining female CEO's of the biggest UK listed firms after Marjorie Scardino, ex- CEO of Pearson, and her counterpart at Anglo American, Cynthia Carroll, left office within the last year.

The number of women FTSE executives is everything but encouraging, attention should shift from looking at departing female CEOs to the real causes of the gender gap. The core of the problem is the continuing lack of a 'pipeline' of female talent, which would allow women in management roles to move to top positions. More direct intervention may still be required from companies to achieve this.

The Government says that the figures published on October 2013 as part of its Women on Board initiative, spearheaded by Lord Davies, show that the UK is making good progress in reaching the target of 25% of board positions being held by women by 2015.

Big Jump Needed in Next 2 Years

Figures for the FTSE100 show that:

- 19% of directors are female (up from 12.5% when Lord Davies reported in February 2011 and 17.4% in May 2013).
- 23.8% of non-executive directors are female (up from 15.6% in February 2011 and up from 22% in May 2013
- 6.1% of executive directors are women (up from 5.5% in February 2011 and up from 5.6% in May 2013)
- 24% of board appointments since 1 March 2013 have been women. In May 2013 this was 12%
- In order to reach Lord Davies' target of 25%, FTSE100 companies need to appoint 66 more female directors in the next 2 years.

FTSE 350 figures had only slight improvement

The Cranfield School of Management published a November report titled "Women on Boards, Benchmarking adoption of the 2012 Corporate Governance Code in FTSE 350", which presents the latest figures on the number of women on boards of UK's 350 biggest listed companies and the pace of change over the past six months.

The report suggests that since the Davies Report in March 2011, the percentage of female-held directorships on FTSE 100 boards has increased to 18.9 per cent and on FTSE 250 boards to 14.9 per cent. Despite this encouraging trend the percentage of new director appointments going to women will need to increase substantially if Lord Davies' target of 25 per cent by 2015 is to be met.

The analysis of companies' annual reports also showed that 65 per cent of the FTSE 100 companies and only 18 per cent of FTSE 250 companies had stated a clear policy on board diversity.

Euro Stories

Lagging fund activism in Europe
Hedge fund activism is much more prevalent in the US as in Europe due to various cultural and regulatory reasons.

While hedge fund activism is widespread in the US, similar investor campaigns seeking corporate change face many more hurdles in Europe. According to figures from Activist Insight only 34 companies were targeted by public activist campaigns in Europe this 2013 compared with 149 in the US over the same period. It seems that in the European investment culture, activism is much less acceptable and mostly takes place behind closed doors in contrast to the well publicised campaigns in the US.

Maarten Wildschut, lead portfolio manager at RWC, believes it is harder to be an aggressive activist in Europe than in the US: "The regulatory landscape in Europe is much more complex, the remit of company boards is broader and more opaque and lots of European companies have dual shareholder structures." Added to this is also Europe's fragmented market structure, the prevalence of powerful family shareholders and widespread corporate hostility towards media involvement in shareholder disputes. Shareholders and asset managers should also be wary about widely believed but unfounded assertions about the negative impact of investor activism on company performance.

A new study conducted by scholars from Harvard Law School, Duke University and Columbia Business School examined 2,000 interventions by activist hedge funds during the period 1994 – 2007 over a long time window of five years following the intervention. The evidence shows that interventions by activist shareholders, including hedge funds, do not have an adverse effect on the long-term interests of companies and shareholders and that companies' operating performance actually improved after activist interventions.12

French green bond demand signals growing investor interest

A new €1.4bn green bond issued in November by French state-controlled utility Électricité de France (EDF) to finance renewable projects has met with strong demand from institutional investors.

EDF, the world's largest producer of electricity with a strong bias towards nuclear energy, said the 7.5-year issue was the first green bond in euros by a large corporate and that it was "twice oversubscribed" and a "great success among institutional investors". The strong demand specifically came from investors integrating environmental, social and governance (ESG) criteria in their investment decisions – accounting for 60% of the allocation.

“Through this transaction, the group has over achieved its objective to attract new investors,” said EDF, which is 84.4% owned by the French state. It said this initial transaction was a major commitment which paves the way for new channels of financing for other EDF businesses, such as hydropower and energy services.

Proceeds will go exclusively towards financing future renewable energy projects led by its subsidiary EDF Energies Nouvelles [New Energies]. The projects will have to comply with eligibility criteria drawn up by French ESG ratings house Vigeo with verification by Deloitte. EDF Energies Nouvelles has a gross installed capacity of 6.4GW and a 1.5GW pipeline. Wind is the main component of its mix, accounting for 87% of total installed capacity.

French investors took 36% of the issue, according to the Climate Bonds Initiative group, a project of the Network for Sustainable Financial Markets and CDP [Carbon Disclosure Project]. German and Austrian investors accounted for 17% while Southern European players took 10%. By type they were fund managers (70%), central banks (13%) and insurance and pension funds (13%).

In what’s proving a bumper month for green/sustainability bond issues, the EDF bond follows earlier issues from Swedish property company Vasakronan, Bank of America, Norway’s Kommunalbanken, Dutch development bank FMO and the World Bank’s IFC. On top of this, insurance giant Zurich has signalled a €1bn appetite for green bonds.

MEPs back plans to boost transparency on firms’ environmental and social impact

Large companies would be obliged to disclose information on their environmental, social and employee-related impact under a draft law on non-financial reporting approved by Legal Affairs Committee in December 2013.. Disclosure should make them more accountable to investors, consumers and civil society, and help them to manage risks more effectively, say MEPs, who also call on the Commission to consider proposing requirements in 2018 for country-by-country reporting on profits, taxes and subsidies.

The proposed rules would require large EU companies (over 500 employees) to include in their management reports a non-financial statement on the impact of their activities relating to environmental, social and employee matters, including respect for human rights and efforts to combat corruption and bribery. This statement should provide comparable descriptions of the policies, risks and results related to these matters.

Large listed companies would also have to publish information on their diversity policy for boards, including information on the age, gender, disability, ethnic origin and educational and professional background of their members. To help ensure that non-financial information published by companies is comparable, MEPs call on the European Commission to publish guidelines, developed in cooperation with stakeholders, on how to use international standards and non-financial performance indicators. MEPs also amended the proposed rules to ensure that companies are not obliged to publish information on upcoming developments and negotiations if disclosure would “be seriously prejudicial to their commercial position”.

A majority of committee MEPs agreed to propose that when reviewing the directive in 2018 the Commission should consider introducing an obligation for large companies to disclose country-by-county information on profits, taxes and subsidies received where they operate. However, some MEPs wanted to propose including such a requirement immediately.

Swiss pension funds obliged to vote at AGMs under watered down version of Minder

Swiss pension funds will now be obliged to vote at company annual meetings according to the final version of the so-called Minder initiative against excessive executive pay. It means they have failed in their attempt to be exempted from having to vote.

According to the final Minder law, unveiled on in late November 2013 by the Swiss justice ministry and which takes effect on January 1, 2014, the funds will have to vote at listed Swiss firms. Yet the law permits them to abstain if it's "in the interests of their beneficiaries." The law goes on to say that the schemes' management will define exactly what those interests are. The measure further specifies the issues to be voted on – namely board elections, pay for executives and board members and changes to company statutes.

To the delight of Swiss pension fund lobby ASIP, which had opposed the Minder initiative prior to its adoption during a March 3 referendum, the government's original draft law exempted the schemes from voting altogether if their managers felt it conflicted with beneficiaries' interests.

That waiver defied the spirit of the highly popular initiative, which held that pension funds, as guardians of social capital, must take a stand on executive pay by voting at AGMs.

The Minder camp was outraged, accusing the justice ministry of striking a "behind-the-scenes deal" with ASIP to exempt pension funds from the voting requirement. "Close examination of the draft law reveals that the passage concerning the requirement was just copied from a position paper by ASIP and economiesuisse (Switzerland's business lobby)," said fellow proponent Claudio Kuster.

While the ministry denied any backroom deal, it appears that it has realised a full exemption would have subverted Minder, which was supported by 70% of voters.In a statement, ASIP regretted the removal of the full exemption but welcomed being able to abstain.

The Minder law also respects the initiative's original proviso that funds must inform their beneficiaries about how they voted at AGMs. This reporting can, however, take the form of a general summary, which ASIP greeted with relief. Another major change to the initiative is the government's decision to preserve golden handshakes for executives. The original ban on "golden parachutes," or generous severance pay for executives, has also been upheld. The government has given the country's listed companies and their shareholders up to one year to prepare for the new regime.

US Stories

Pressure grows for SEC stock trading rules review

The main US securities regulator is facing fresh pressure to undertake a large-scale review of the rules governing the US equity markets following a call from another of the agency's five main commissioners.

Michael Piwowar, the newest of the five commissioners at the Securities and Exchange Commission, also became the third to call formally for a review of US market structure in recent weeks.

Mr Piwowar, whose background is in market microstructures, said he found it "troubling" that regulators had yet to take up such a study even as it has been more than three years since the May 2010 "flash crash".

His comments are the latest in a series of calls made by other SEC commissioners such as Daniel Gallagher, a Republican appointee like Mr Piwowar, and Luis Aguilar, a Democrat, for the regulatory body to launch such a review. Mr Piwowar said he would be engaging with the other commissioners and Mary Jo White, chair of the SEC, on his return to the US. In October Ms White agreed more should be done but stopped short of calling for a full review.

In his first speech as a commissioner he called for a wide-ranging study akin to the one conducted by the Foresight Committee in the UK. That two-year project, published last year, included the contributions of academics, market practitioners and regulators. "The UK Foresight model is one that we should entertain in the US. The SEC can benefit tremendously from collaboration with market structure experts from both the private sector and the academic world," he told investors at a conference held by ICI Global, an investor trade association, in London.

The rules, known as Regulation National Market Structure (Reg NMS), were implemented in 2007 with the goal of ensuring retail investors received the best possible market price when trading.However, the rules also had the unintended consequence of turning the US equity market into a highly complex and fragmented system where 13 exchanges and 50 alternative trading venues vie for transactions.

A spate of high-profile glitches, such as the flash crash of 2010 where shares oscillated wildly in a matter of minutes and left regulators unable to reconstruct its causes for months, have raised concerns about the role of technology in financial markets. Critics have argued the two trends are interlinked as they have exacerbated the complexity of the market while also pointing a finger at the role of high-frequency traders who have come to dominate the equity markets.

The disputes have also pitted leading stock exchanges against bank-run brokerage businesses as the two more directly compete for trading business.

The Foresight report was a two-year study overseen by the UK government into the future of computerized trading. It called for action to limit sharp swings in financial markets in an effort to manage better systemic risks and argued investors should be protected by reducing so-called "tick sizes", the increments by which asset prices are allowed to fluctuate

CalPERS newsroom an eye opener

Giant California based public servants pension schemes CalPERS launched a new online newsroom late in 2013. Equipped with live Twitter feed and a host of other features it provides an insight into how far the very largest of pension funds will take public transparency of their policies, costs and investments and overall governance in the future. Coupled with the existing live webcasts of Board and Committee meetings and extensive disclosure of shareholder fund engagement ESG and voting activity, the new newsroom is a pointer to where scale economics and overall communications can combine.

Global Stories

More work needed by regulators

Finance Professionals Fear another Crash

An overwhelming majority of finance sector professionals do not believe sufficient steps have been taken by regulators to prevent another crash in markets according to an international survey commissioned by the Financial Times and published late November 2013.

The research of attitudes amongst bank, asset management and hedge fund staff revealed 97% doubted regulators fully understood the causes of the financial crisis and 52% believe that subsequent regulations are not robust enough to prevent a repeat occurrence.

"The results of this survey are no surprise. It is yet another indication that further reform is needed both in regulatory standards and corporate governance to lower the systemic risk in global investment markets" commented Alan MacDougall, Managing Director of PIRC.

2013 Sees More Fines- More International Investigations- Forex markets & insider trading next

The UK financial regulator levied a record £472m in fines on various entities and individuals for 2013, up 51% on the previous 2012 record. Some of the worlds biggest banks have been at the core of serious lapses in governance with penalties levied by the Financial Conduct Authority against JP Moragan, RBS, Rabobank and Lloyds Banking Group being amongst the largest.

The London Whale scandal and the still evolving Libor fraud were major contributors to last years revenue boost with most proceeds going to Treasury. All up, 45 institutions and individuals contributed to the record tally, a small reduction from the 55 entities fined during 2012.

More fines are expected later in 2014 as settlement is reached on on further Libor related scandals that to date has seen a total of $5.8b paid by global financial institutions to settle claims from rigging the key borrowing rate, reported by the Financial Times as underpinning a whopping $350tn of credit products.

The FCA is now turning investigative resources to potential manipulation of benchmark rates in Forex, gold and other indices. According to a report in FT on december 30th, Tracey McDermott FCA head of enforcement said the FCA's Libor investigators, who number about 60-out of a total just shy of of 400 in the regulators enforcement divission-were :transferring the knowledge and lessons learned from investigating Libor' into their enquiries into the forex market.

The FCA also recieved high number of requests for assistance from off-shore regulators during 2013, recording over 1,000 by late December 2013, with expectations that the 2011 high of 1,023 may be exceeded.

Many of the requests have come from US based regulators as cross border coordination increases, in part driven by Libor, with another 10 domestic regulatory authorities from countries around the world still conducting separate investigations into the scandal. Insider trading is also on the agenda of international regulators, with the UK regulator recording a 2013 increase in arrests, whilst a doubling of fines issued by the French regulator, a tripling of investigations in Australia and increases in investigations reported in both Hong Kong & German authorities.

The SEC opened 908 investigations for 2013 up more than 10% on 2012, with a spokesman quoted in the Financial Times saying 'We have brought a record number of insider trading actions in the last four years and will continue to do so.'

China: Beijing and Shanghai Launch Carbon Emissions Trading Pilots – November & December 2013

Two of China's largest carbon emissions trading pilots launched in late November 2013. Once all 7 pilots are operating, 10% of China's emissions will be covered. Market mechanisms will play a much stronger role in environmental protection in the future.

In late November 2013, carbon Emissions Trading Pilot Schemes were launched in Shanghai and Beijing with carbon traded at 27 yuan (3.3 Euros) and 51 yuan (6.1 Euros) per tonne respectively. These are the second and third of China's pilots to launch. The first, in Shenzhen, started trading in June 2013 with an average trading price of 80 yuan (around 10 euros per tonne). Two more pilots (Guangdong and Tianjin) launched in December.

In October 2012, China's powerful super planning Ministry, the National Development and Reform Commission (NDRC), made a commitment to develop emissions trading. They planned to develop carbon trading in 5 municipalities and 2 provinces on a trial basis by 2013, moving to a national scheme by 2020. Based on analysis from UK Trade & Investment the pilots will regulate nearly 1 gigatonne of carbon dioxide every year, representing about 10% of the country's total emissions. The initial cap will match China's carbon intensity target (improving 17% between 2011-2015) but not yet go beyond. The launch of the pilots in China's political and financial capitals is a highly symbolic step towards fulfilling this commitment.

Over the past two years, the governments in the pilot cities and provinces have released their "implementation plans" that form the basis for local emissions trading schemes, and collected emissions data from target enterprises that create the basis for allocating emission allowances. There is a temporary legal basis and punishments can be levied if enterprises fail to comply. But more effective will be the political pressure to comply, and the competition between the pilots to succeed.

There has also been progress on a national level ETS. In October the NDRC issued "Guidance on Greenhouse Gas Measurement and Reporting" in ten major emitting sectors, including power, the grid, steel, petrochemicals, cement and airline industries. A national registry to support a voluntary based carbon trading and offsetting system went online in November 2013.

The launches are an important step forward in developing China's carbon market. The clearly articulated purpose of the pilots is capacity building and lesson learning. At the same time the NDRC will need to develop the national infrastructure for a scaled up market, possibly linking the pilots up into a national scheme. Enormous challenges lie ahead, particularly activating the market, improving Monitoring, Reporting and Verification (MRV), setting effective caps and getting an effective legal framework in place.

The size of the seven pilots matters in comparison to the total economy. Together they contribute 25% of China's GDP, consume 20% of national energy and are largely coal-based. The launch of ETS pilots in Beijing, Shanghai and Shenzhen sets a powerful example for the rest of the country and provides evidence for national decision makers. The UK has been working with the Chinese authorities at pilot and national level to help develop the schemes.

The recent Third Party Plenum set a framework for the future in which the market will play a much stronger role in managing resources and making the polluter pay.

Signs of global improvement in Q4

Global equity markets continued to rally in the fourth quarter of 2013. The MSCI World Index gained 8.5%, as many of the major worries that dominated the investment landscape earlier in the year faded. Sentiment was lifted by the US Federal Reserve's decision on tapering its asset purchase programme and the improving economic outlook globally, but most notably by the end of the eurozone recession.

In December the Fed announced it would start to reduce the pace of its asset purchases from January 2014, from $85 billion to $75 billion per month.
The tapering announcement was broadly welcomed by investors and equities rose. The Fed's decision is ultimately a positive signal about the strength of the US economy and a return to more normal conditions. The US economy expanded by 4.1% on an annualised basis in the third quarter of 2013, with the pace of growth expected to pick up in 2014.

The eurozone moved out of recession in the third quarter of 2013 and economic data suggests that the economic expansion continued in the fourth quarter. And composite PMI ended the year at 52.1, a three-month high. The period of relative financial calm and economic stabilisation led to increased capital flows into the region and European equities rose by 6.0%. However, while the peripheral economies improve there are growing concerns about the French economy.

Standard and Poor's cut the country's credit rating to AA based on the lack of economic reform. Good progress was made on the EBU and a deal was reached that included a regional approach to risk and a commitment to burden sharing that may help start 2014 with some momentum.

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QUARTERLY ENGAGEMENT REPORT

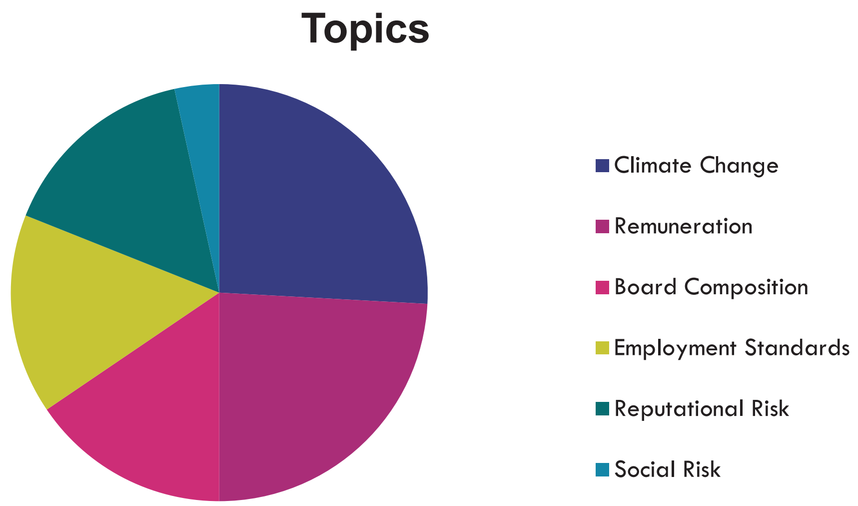
OCTOBER TO DECEMBER 2013

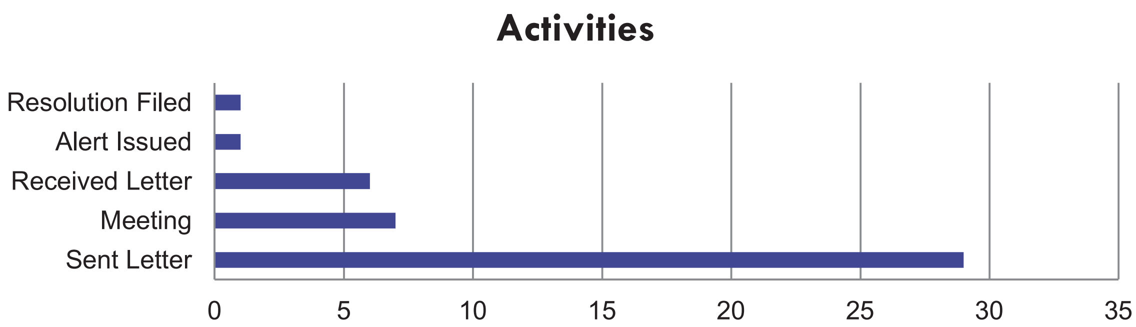
Local Authority Pension Fund Forum

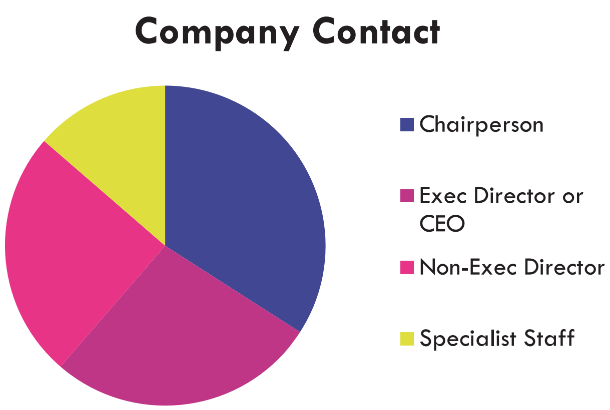
LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest. Formed in 1990, the Forum brings together a diverse range of local authority pension funds in the UK with combined assets of over £120 billion.

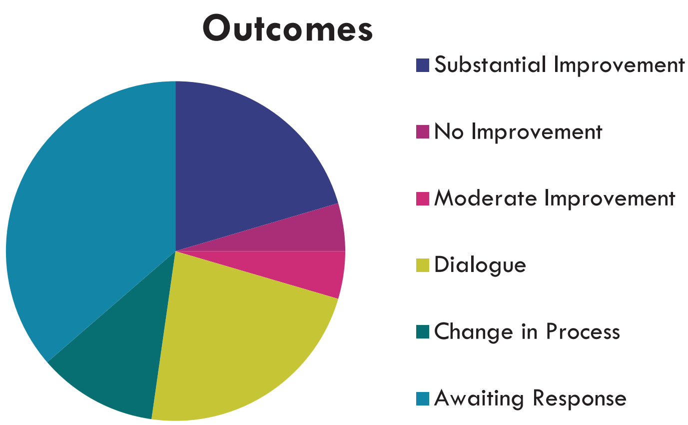
ENGAGEMENT SUMMARY

OCTOBER TO DECEMBER 2013









ACHIEVEMENTS

- Met with **Standard Chartered, M&S** and **Burberry** to discuss remuneration issues and get company feedback on LAPFF's 'Expectations for Executive Pay' document.
- Corresponded with **Afren**, **easyJet** and **G4S** regarding pay practices and pay complexity and to seek further meetings.
- Explored the impact of governance changes at **Twenty-First Century Fox** since the split from News Corporation and discussed the approach to the ongoing phone hacking scandal.
- Focussed on 'stranded assets', carbon management strategies and CDP performance scores with **BP**. A meeting with **GlencoreXstrata** also initiated a discussion on these issues.
- Sent a letter to **Oracle** outlining LAPFF's concerns about executive pay. The Company lost its pay vote for the second year in a row, but the Board remains defiant.
- Co-signed letters to major US, European and Japanese consumer companies in the **palm oil** supply chain on the sustainability of their supplies.
- Responded to a **FRC** consultation on the strategic report raising concerns about its status and compatibility with UK Company Law, and to a FRC consultation on directors' remuneration. Provided input to the **SEC** on pay ratio disclosure.

THE FORUM IN THE NEWS

Investor pressure for mandatory auditor rotation
Professional Pensions

LAPFF joins investors in demand for an independent chairman at 21st Century Fox
The Telegraph

Two new local authority pension funds join LAPFF
Professional Pensions

LAPFF joins investors to renew push for mandatory audit rotation
Professional Pensions

Legal concerns over IFRS
Economia

COMPANY ENGAGEMENT

LEADERSHIP ON KEY CAMPAIGNS

The Forum met with Rod Eddington, the lead independent director of **21st Century Fox** (formerly **News Corporation**) at the start of October, shortly before the company's AGM. LAPFF repeated its belief that the company would benefit from the appointment of an independent chair, and that this could aid the succession process. At the company's AGM in the middle of the month, two thirds of independent shareholders backed a resolution calling on the company to appoint an independent chair. LAPFF had issued an alert advising members to support the resolution.

LAPFF is a member of the Investor Group of the 30% club which co-ordinates the investment community's approach to engaging with companies on board gender diversity. Together with four other investors in this group, LAPFF has written to **Vedanta, Antofagasta** and **London Stock Exchange** as companies that currently have no women on their boards, to request a meeting. A meeting with the chairman of the London Stock Exchange has been arranged.

Following a request from a member fund, LAPFF has undertaken work on the issue of blacklisting. At the October business meeting it was agreed to write to the major construction firms, and to encourage them to press ahead with the creation and implementation of a compensation scheme for those workers who had been affected by blacklisting.

PROMOTING GOOD GOVERNANCE

Global Focus List

LAPFF first corresponded with **Burberry** in December 2012, due to concerns over board and committee independence as well as concerns over remuneration targets and termination payments. At that time the company did not respond and the Forum issued a voting alert for the AGM to flag up these concerns. Eventually a meeting was arranged, at which company views were sought on pay practices, particularly regarding the potential for excessive rewards, guaranteed termination payments, and use of adjusted profit measures. Just days following the meeting, it was announced that the CEO Ms Ahrendts had resigned from Burberry to join Apple.

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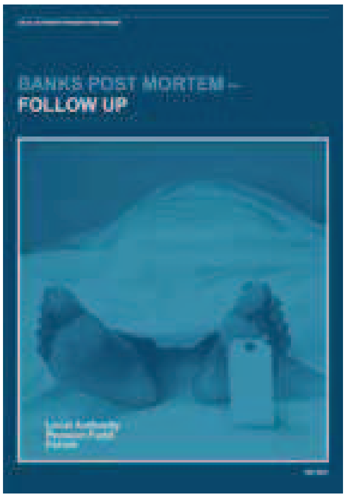
Financial Reporting & Audit

Launched at the LAPFF conference, the Banks Post Mortem follow-up provides a summary of LAPFF's concerns over the consequences of the implementation of International Financial Reporting Standards (IFRS) and the link to the collapse of the capital adequacy regime of banks in UK and the Republic of Ireland.



In the summer of 2013, LAPFF, together with a consortium of other asset owners, sought Counsel's Opinion on the consistency between IFRS and the Companies Act 2006. The Opinion from Mr George Bompas QC cast doubt on the requirements under IFRS compared to applicable law under the Companies Act 2006. The Opinion also addressed whether Martin Moore QC's 2008 Opinion for the Financial Reporting Council (FRC) could be relied upon. Mr Moore responded on behalf of the FRC in October 2013. The Bank Post Mortem follow-up provides a detailed analysis of Mr Moore's response and sets out the Forum's view that an independent enquiry into the failures of the IFRS standard setting and adoption process is needed to settle matters within an appropriate timescale.

In October, the **Competition Commission** issued a final report on proposed changes to open up the UK audit market to greater competition. The proposals include that companies must retender the audit every ten years with a five year period preferred. LAPFF, in conjunction with other investors, had written to the Competition Commission in May 2013 reiterating support for a regulatory backstop to audit tenure as well as limits to non-audit fees. Other changes include that there must be a shareholders' vote at the AGM on whether Audit Committee Reports in company annual reports are satisfactory. LAPFF had called for a statutory shareholder vote on audit committee reports in 2010 noting that it allows investors to review the quality of reporting and indicate to the company when it is perceived as inadequate.

Executive Pay

Meetings continued with companies to solicit feedback to LAPFF's Expectations for Executive Pay document. The Remuneration committee chair at **Marks & Spencer**, who is also the chief executive of National Grid, provided extensive and practical feedback on LAPFF's approach, supporting some proposals whilst agreeing to differ on others. Particularly useful was his perspective on the differing approaches of US shareholders. **Standard Chartered**'s chairman provided a useful company perspective on global pay practices and the pay matrices used by the company for executive remuneration. The discussion also covered ongoing board transition and succession planning.

A meeting has been arranged with **BT Group** to discuss the 'Expectations' document, prompted by the company's decision to reduce the short-term bonus opportunity for the Chief Executive of BT Retail. The Forum has also corresponded with **Afren**, **easyJet** and **G4S** regarding pay practices and pay complexity and to seek further meetings.

MANAGING ENVIRONMENTAL RISK

Carbon Asset Risk

Earlier this year, LAPFF joined other global investors to write the 50 largest energy and power companies, asking for disclosure on capital expenditure (capex) plans and the risks associated with development and use of reserves in light of the emerging stranded assets debate.

LAPFF, together with a group of UK investors, met with **BP** representatives to explore further the investment issues raised by this letter and to determine the company's approach to capex on reserves in the future. BP has announced a focus on value over volume, recognising that demand risk is directly linked to price risk, and is preparing a response to the investor group's request.

Following the merger earlier in the year, the new **Glencore Xstrata** presented the new group sustainability approach to a gathering of investors in a morning session followed by 'one-on-one' meetings in the afternoon. LAPFF noted its appreciation of the attendance by two board directors. The meeting covered a range of issues including business ethics, safety and human rights as well as the company's approach to carbon asset risk.

Palm oil

The Forum has engaged with UK companies on the use of sustainable palm oil for a number of years, and continues to raise this in relevant company meetings. Support for emerging standards by investors can be critical in moving the industry forward and several companies are making significant progress towards 100% certified sustainable sources. LAPFF has joined a number of institutional investors in contacting major consumer companies in the palm oil supply chain to open a conversation on the sustainability of their palm oil supplies. These companies are mainly based in the US, but also Europe and Japan.

Unilever announces that 100% of the palm oil it buys will be traceable to known sources by end 2014

(Dec 2013)

TARGETING SOCIAL ISSUES

Employment Standards

LAPFF continued to engage with companies on the impact of the RANA Plaza factory collapse and how they have changed their approaches to factory safety. Following our meetings with Sainsbury's and Next last quarter, the Forum sought a meeting with **N Brown Group** to find out how the board has responded to the increased scrutiny on Bangladesh.

The chairman of **Tesco** provided a written response providing detailed information on actions taken since the disaster and further commitments made to improve standards. At a meeting with **Burberry,** the company noted it deliberately does not use suppliers from Bangladesh, considering it a very difficult country to work in.

Following media coverage on **Lonmin's** actions during the 2012 Marikana mine incident, the Forum corresponded again with the company to hear their side of the story. The company responded noting that the 2013 annual report would have cover a range of socio-economic issues and an update would be provided on the five social initiatives at the 2014 AGM.

During the quarter, a campaign was initiated by ShareAction to raise awareness of the Living Wage amongst pension funds. LAPFF has raised the issue of the Living Wage in its engagement with a number of companies, and a briefing has been made available to members providing details of this engagement in order for members to respond.

Earlier in the year, LAPFF had met with **Deutsche Post** to encourage the company to commit to towards applying the same high employee standards as exhibited by its German operations to its operations in other countries. In October it was announced that the company had given union recognition to its Turkish supply chain staff.

Following three years of engagement with **National Express** on its approach to unionisation in the US, some LAPFF funds have joined other investors in co-filing a resolution to the company's May 2014 AGM to support improved oversight of its human capital strategy.

CONSULTATIONS & PUBLIC POLICY

ENGAGING WITH POLICY-MAKERS

The LAPFF chair met with a delegation from the **Japanese Ministry of Economy, Trade and Industry (METI)** headed by Mr. Yukihiro Sato, Chairman of Corporate Financial Executive Committee. METI had sought the meeting due to a persistent concern about IFRS within Japan and was aware of the view expressed by LAPFF and work undertaken in this regard. Japan has decided to allow companies to use IFRS, but are carefully assessing which standards should be used, whether Japanese GAAP or IFRS only on a consolidated basis, and which standards should be improved and how.

LAPFF continues to respond to proposed changes to the structure of Local Government Pension Schemes with a report submitted to the investment and engagement sub-committee of the **Shadow Pensions Board** on LAPFF's unique contribution to stewardship of pension fund assets.

CONSULTATION RESPONSES

The **Financial Reporting Council** issued Guidance on the Strategic Report for consultation which the Forum responded to in November. In its response, LAPFF raised fundamental questions about the status and compatibility of the proposed Report with UK Company Law and the preparation of annual accounts for shareholder approval. LAPFF also contributed to the response of the Investor Group of the **30% Club** of which the Forum is a member. This response included the recommendation that companies report on female representation not only on the executive committee, but also for two levels below this.

The Forum also responded to an **FRC** consultation on Directors' remuneration, looking at whether certain amendments to the UK Corporate Governance Code would be required to address some potential issues on executive remuneration. The response reflected a number of views as set out in LAPFF's 'Expectations on Executive Pay' as well as the overall approach of the report 'People and Investment Value'.

Continuing to promote improvements to the regulatory framework on governance, LAPFF responded to a consultation by the **Securities and Exchange Commission (SEC)** consultation on disclosure of pay ratios. The Forum supported SEC action to facilitate meaningful corporate disclosure of executive pay ratios and flagged up various points to consider in developing guidance for the implementation methodology. All LAPFF consultation responses can be viewed at: http://www.lapfforum.org/consultations.

In support of those member funds who are also PRI signatories, LAPFF provided input on Forum engagement activity for the on-line reporting tool, a reporting framework which signatories must complete.

NETWORKS & EVENTS

The sell-out LAPFF 2013 conference '***Licence to Operate: Holding Companies to Account***' was presided over the LAPFF chair who led debate on the future of the Local Government Pension Scheme. Discussions with active investors on enhancing company value were followed by Josh Hardie of Tesco providing a company perspective on community responsibilities. A session on climate risk and 'stranded assets' included topical contributions from both an investor and company perspective. Lord Myners closed the conference setting out lucidly why capitalism without owners will fail. Other events attended included:

- **Achieving zero emissions** – lecture by OECD Secretary General
- **Green Light Report Launch** – hosted by ShareAction
- **BP Business Reception 2013**
- **Women in the workplace** – hosted by Rt Hon Maria Miller MP
- **Law Commission Fiduciary Duty Event** – hosted by UKSIF
- **GlencoreXstrata sustainability presentation**

COMPANY PROGRESS REPORT

Company	Topics	Outcome
Afren	Remuneration	Change in Process
Antofagasta	Board Composition	Awaiting Response
Bellway	Governance (General), Board Composition	Substantial Improvement
BP	Climate Change	Moderate Improvement
BT Group	Remuneration	Dialogue
Burberry	Remuneration, Board Composition	No Improvement
easyJet	Remuneration	Dialogue
Exxon Mobil	Climate Change	Dialogue
G4S	Remuneration	Dialogue
General Mills	Climate Change	Awaiting Response
Glaxo Smithkline	Remuneration	Moderate Improvement
Hormel Foods	Sustainable Palm Oil	Awaiting Response
J.M. Smucker	Sustainable Palm Oil	Awaiting Response
Kellogg Company	Sustainable Palm Oil	Awaiting Response
Kraft Foods	Sustainable Palm Oil	Awaiting Response
London Stock Exchange	Board Composition	Awaiting Response
Lonmin	Employment Standards, Social Risk	Dialogue
Marks & Spencer	Remuneration	Substantial Improvement
Mondelez International	Sustainable Palm Oil	Awaiting Response
N Brown Group	Employment Standards, Reputational Risk	Dialogue
National Grid	Climate Change	Substantial Improvement
Nestle SA	Climate Change	Awaiting Response
Oracle	Remuneration	Awaiting Response
PepsiCo	Sustainable Palm Oil	Awaiting Response
Rio Tinto	Climate Change	Substantial Improvement
Standard Chartered	Remuneration	Substantial Improvement
Tesco	Employment Standards, Reputational Risk	Substantial Improvement
The Hershey Company	Sustainable Palm Oil	Awaiting Response
The Hillshire Brands Company	Sustainable Palm Oil	Awaiting Response
Toyo Suisan Kaisha	Sustainable Palm Oil	Awaiting Response
Twenty-First Century Fox	Board Composition, Reputational Risk	Change in Process
Vedanta	Board Composition	Awaiting Response

Companies LAPFF has not previously engaged with are indicated in bold. 'Awaiting response' indicates a letter was sent to the company in the quarter and a response not received in this period.

Local Authority Pension Fund Forum

The Local Authority Pension Fund Forum was established in 1991 and is a voluntary association of local authority pension funds based in the UK. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which its members invest. The Forum's members currently have combined assets of over £120 billion.

Report prepared by PIRC Ltd. for the Local Authority Pension Fund Forum

PIRC

www.lapfforum.org

Aberdeen City Council
Avon Pension Fund
Barking and Dagenham LB
Bedfordshire Pension Fund
Camden LB
Cheshire Pension Fund
City of London Corporation
Clwyd Pension Fund
Croydon LB
Cumbria Pension Scheme
Derbyshire CC
Devon CC
Dorset County Pension Fund
Dyfed Pension Fund
Ealing LB
East Riding of Yorkshire Council
Enfield
Falkirk Council
Greater Gwent Fund
Greater Manchester Pension Fund
Greenwich Pension Fund
Gwynedd Pension Fund
Hackney LB
Haringey LB
Harrow LB
Hounslow LB
Islington LB
Lancashire County Pension Fund
Lewisham LB
Lincolnshire CC
London Pension Fund Authority
Lothian Pension Fund
Merseyside Pension Fund
Newham LB
Norfolk Pension Fund
North East Scotland Pension Fund
North Yorkshire CC Pension Fund
Northamptonshire CC
NILGOSC
Nottinghamshire CC
Rhondda Cynon Taf
Shropshire Council
Somerset CC
South Yorkshire Integrated Transport Authority
South Yorkshire Pensions Authority
Southwark LB
Staffordshire Pension Fund
Surrey CC
Teesside Pension Fund
Tower Hamlets LB
Tyne and Wear Pension Fund
Waltham Forest LB
Warwickshire Pension Fund
West Midlands ITA Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund
Wiltshire CC
Worcestershire CC

Pension Fund Committee
Meeting to be held on 27 March 2014

Electoral Division affected: All

External Audit
Lancashire County Pension Fund Audit Plan 2013/14

Contact for further information:
Karen Murray, 0161 234 6364, Director, Grant Thornton
karen.l.murray@uk.gt.com

Executive Summary

The Audit Plan sets out the nature and scope of work that the Authority's external auditor will carry out to discharge its statutory responsibilities, compliant with the Audit Commission Act 1998 (the Act) and the Code of Audit Practice for Local Government.

This audit plan is specific to the financial year 2013/14 and sets out in broad terms the programme of work required to:

- give a financial opinion on whether the financial statements:

– give a true and fair view of the financial position of the Pension Fund as at 31 March 2014 and of its expenditure and income for the year then ended; and

– have been prepared in accordance with proper accounting practice.

The Audit Plan, setting out the process that underpin the audit is at Appendix A. The Plan will be reported to the Council's Audit and Governance Committee on 31 March 2014.

Recommendation

The Committee is asked to note the External Audit plan for the audit of the County Pension Fund for 2013/14.

Lancashire County Council

Background and Advice

Attached at Appendix 'A' is the external auditor's Audit Plan for the audit of the Lancashire County Pension Fund. The plan sets out the main risk areas which the audit will focus on and how the audit team plans to obtain the necessary assurances. The risks relate to the three key elements of the fund accounts being:

- investments,
- contributions and
- benefits payable.

The fee for the audit of the pension fund has been set at £35,906.

(Note: The scale fee set by the Audit Commission for pension fund audits is based on a formula linked to the size of the net assets of the fund and has no specific risk factors linked to it).

Karen Murray, Engagement Lead, will attend the meeting to present the report and answer any questions.

Consultations

The report has been agreed with the Deputy County Treasurer.

Implications

This item has the following implications, as indicated:

Risk management

No significant risks have been identified.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
N/A		

Appendix ‘A’

The Audit Plan for Lancashire County Pension Fund

Year ended 31 March 2014

March 2014

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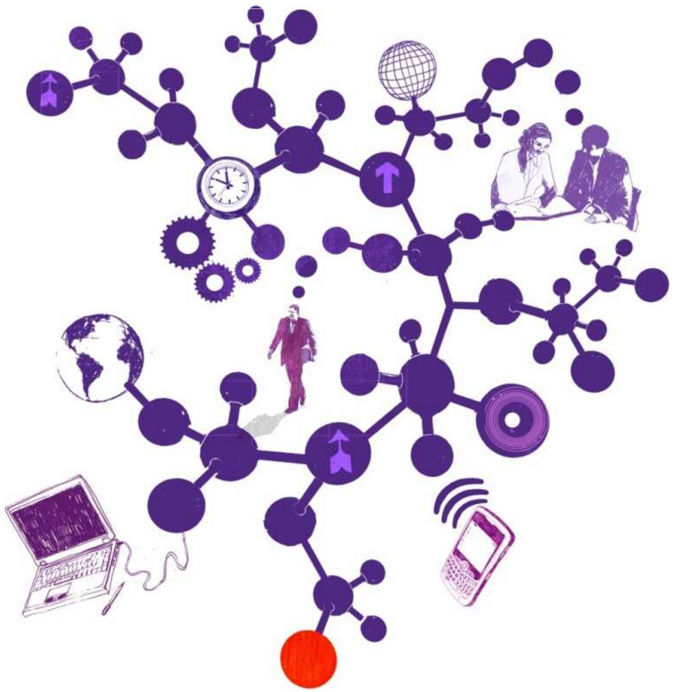

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Fund or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Contents

Understanding your business

In planning our audit we need to understand the challenges and opportunities your Pension Fund is facing. We set out a summary of our understanding below.

Challenges/opportunities

1. Increasing complexity of investments within internally managed fund

- As part of the diversification of investments, the internally managed funds are being targeted towards more fixed income, credit instruments, emerging market funds and company assets

2. Financial Pressures

- Pension funds are increasingly disinvesting from investment assets to fund cash flow demands on benefit and leaver payments not covered by contributions and investment income. Investment strategies need to respond to these demands as well as the changing nature of investment markets.

3. Triennial valuation

- Following the 31 March 2013 actuarial valuation the scheme is in the process of considering the level of additional employer deficit contributions required and how to fund them.

4. Local government restructuring and outsourcing

- With increasing outsourcing services and Directions which require equivalent pensions to be provided to transferred staff, LGPS funds are admitting more private companies.
- Increased number of admitted bodies may increase risks for the fund in the event of those bodies failing.

5. Probation trust pension fund merger

- Reforms of probation services include the Greater Manchester Pension Fund acting as LGPS Fund for the National Probation Service and Community Rehabilitation Companies.
- Regulations have been delayed; transfer may be phased from June 2014.

Our response

1.

- We will review the nature of these investments and the methods being used to estimate the fair value of those investments at 31/3/2014.
- We will assess the appropriateness of the valuation basis and assumptions being used to arrive at a fair value.

2.

- We will monitor any changes to the Pension fund investment strategy through our regular meetings with management.
- We will consider the impact of changes on the nature of investments held by the pension fund and adjust our testing strategy as appropriate

3.

- We will maintain regular dialogue with management to assess the impact this has on the administration of the pension fund and any required disclosures in the 2013/14 pension fund financial statements.

4.

- Through our regular liaison with officers we will consider the impact of any planned large scale TUPE transfers of staff and the effect on the pension fund.

5.

- We will discuss with officers arrangements in place to effect the transfer including data transfer and transfer of investment assets.

Developments relevant to your Pension Fund and the audit

In planning our audit we also consider the impact of key developments in the sector and take account of national audit requirements as set out in the Code of Audit Practice and associated guidance.

Developments and other requirements

1. Financial reporting

- There are no significant changes to the Pension Fund financial reporting framework as set out in the CIPFA Code of Practice for Local Authority Accounting (the Code) for the year ending 31 March 2014.

2. LGPS 2014

- Planning and implementing of the Career Average Revalued Earnings scheme (CARE), effective from 1 April 2014, will impact on the workload of the pensions administration team.
- The new scheme is likely to be more complex to administer and will require changes to systems and processes.
- This, together with changes to governance arrangements may impact on the capacity to respond to audit queries.

3. New governance arrangements

- The Act requires an increased governance regime requiring that each scheme appoint a Scheme Manager who will be assisted by a Pension Board.
- The CLG has consulted on these and regulations are expected in 2014 with implementation expected by April 2015 at the latest

4. The Pensions Regulator

- The Act also provides for The Pensions Regulator (TPR) to oversee the operation of LGPS schemes and to set standards of governance and administration.
- The fund will need to monitor compliance with the requirements set by TPR.

5. Structural change and efficiency

- DCLG has signalled its intention to consider the future structure of the LGPS to improve efficiency and performance.
- LGPS management expenses are increasingly under scrutiny. In response, CIPFA intends to issue guidance on reporting in 2014.

Our response

1. Financial reporting

- We will ensure that the Pension Fund financial statements comply with the requirements of the Code through our substantive testing.

2. LGPS 2014

- We will discuss with officers the progress and implementation of LGPS 2014 in our regular meetings. If appropriate will report any observations.
- We will plan our audit and agree timetables with officers, including pension administrative staff, to ensure our audit causes minimal disruption.
- In the 2014/15 audit we will consider the changes to the control environment in response to LGPS data requirements.

3. New governance arrangements

- We will consider the Pension Fund's revised governance arrangements, including the proposed separate annual governance statement, as they develop and share good practice on emerging new arrangements

4. The Pensions Regulator

- We will share our experiences of working with TPR as you prepare for the new regulatory regime.
- From 1 April 2015 we will consider our reporting responsibilities to TPR. We will discuss any report with officers and the Pensions Committee

5. Structural change and efficiency

- We will share with you good practice in reducing administration costs through collaboration or other initiative.
- Once issued, we will consider the CIPFA guidance and discuss with officers
- We will discuss any proposals for structural change and their impact on the pension fund with officers.

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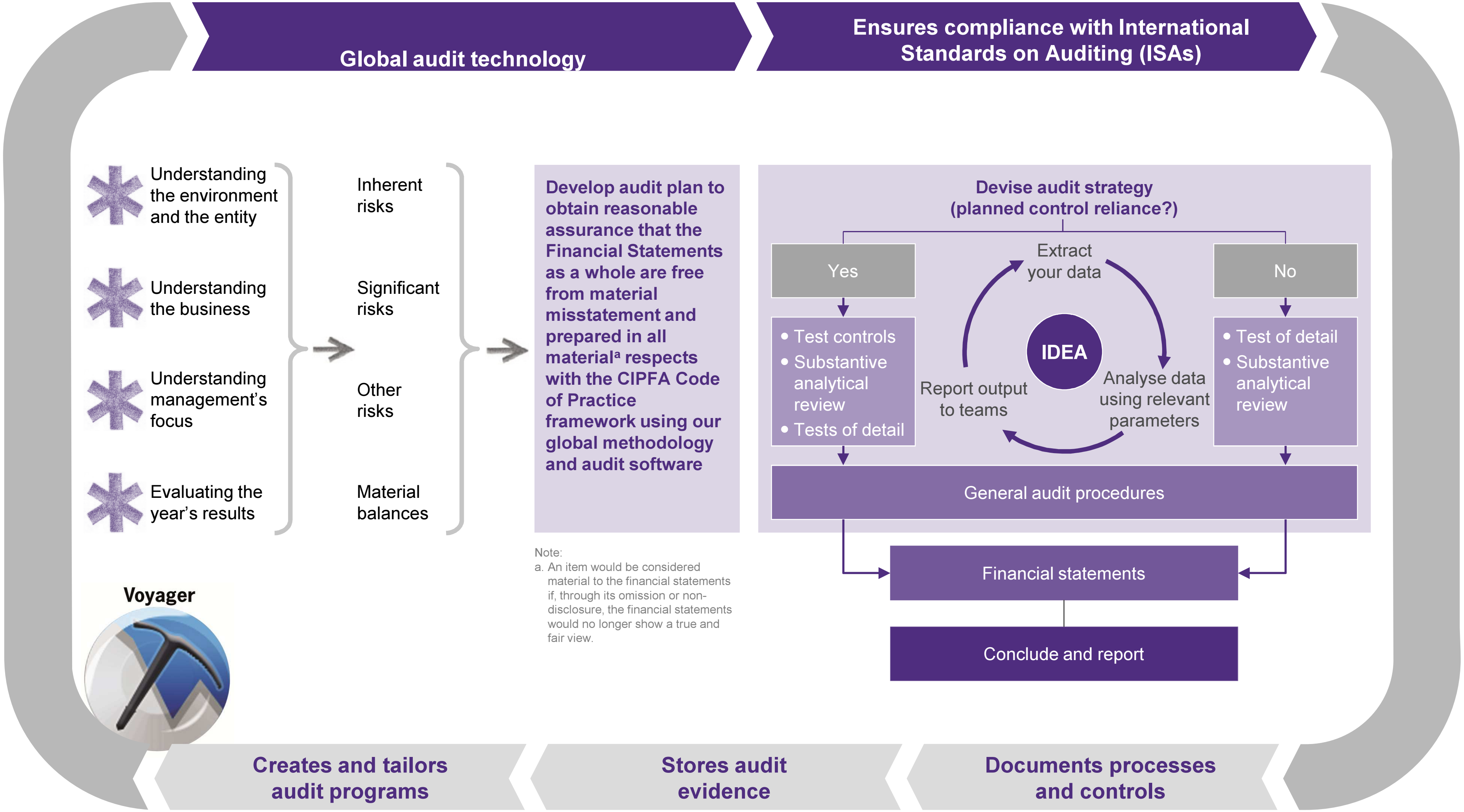
Our audit approach



Significant risks identified

'Significant risks often relate to significant non-routine transactions and judgemental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgemental matters may include the development of accounting estimates for which there is significant measurement uncertainty' (ISA 315).

In this section we outline the significant risks of material misstatement which we have identified. There are two presumed significant risks which are applicable to all audits under auditing standards (International Standards on Auditing (ISAs)) which are listed below:

Significant risk	Description	Substantive audit procedures
Revenue	Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition.	We have rebutted this presumption and therefore do not consider this to be a significant risk for Lancashire County Pension Fund. this is because: • The nature of the Pension Fund's revenue is in many respects relatively predictable and does not generally involve cash transactions. • The split of responsibilities between the Pension Fund, its Fund Managers and the Custodian, provides a clear separation of duties reducing the risk around investment income. • Revenue contributions are made by direct salary deductions and direct bank transfers from admitted /scheduled bodies and are supported by separately sent schedules and are directly attributable to gross pay making any improper recognition unlikely. • Transfers into the scheme are all supported by an independent actuarial valuation of the amount which should be transferred and which is subject to agreement between the transferring and receiving funds.
Management over-ride of controls	Under ISA 240 there is a presumption that the risk of management over-ride of controls is present in all entities.	• Review of accounting estimates, judgements and decisions made by management • Testing of journal entries • Review of unusual significant transactions

Other risks

The auditor should evaluate the design and determine the implementation of the entity's controls, including relevant control activities, over those risks for which, in the auditor's judgment, it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures (ISA 315).

In this section we outline the other risks of material misstatement which we have identified as a result of our planning.

Other reasonably possible risks	Description	Planned audit procedure
Investments	Investments not valid Investments activity not valid Alternative Investments not valid Fair value measurement not correct	We will: • See independent verification of year end holdings and in-year purchases and sales from the fund managers and the custodian • review the reconciliation between information provided by the fund managers, the custodian and the Pension Fund's own records and seek explanations for any variances. We may also have to test a sample of purchases and sales during the year back to detailed information provided by the custodian and fund managers. • test the valuation of a sample of the individual investments held by the Fund at the year end. for any unquoted investments we will critically assess the assumptions and basis of underlying estimations of investment values • Complete procedures to enable us to rely on pension fund's property valuers in respect of property investments • Confirm the existence of investments directly with the independent custodian and property valuer or by agreement to relevant documentation.
Benefit Payments	Benefits improperly calculated/claims liability understated	We will: • perform tests of controls over new pensions in payment and associated lump sum benefits. • rationalise pensions paid with reference to changes in pensioner numbers and increases applied in the year together with comparing pensions paid on a monthly basis to ensure that any unusual trends are satisfactorily explained. • compare the movements on membership statistics to material transactions in the accounting records.

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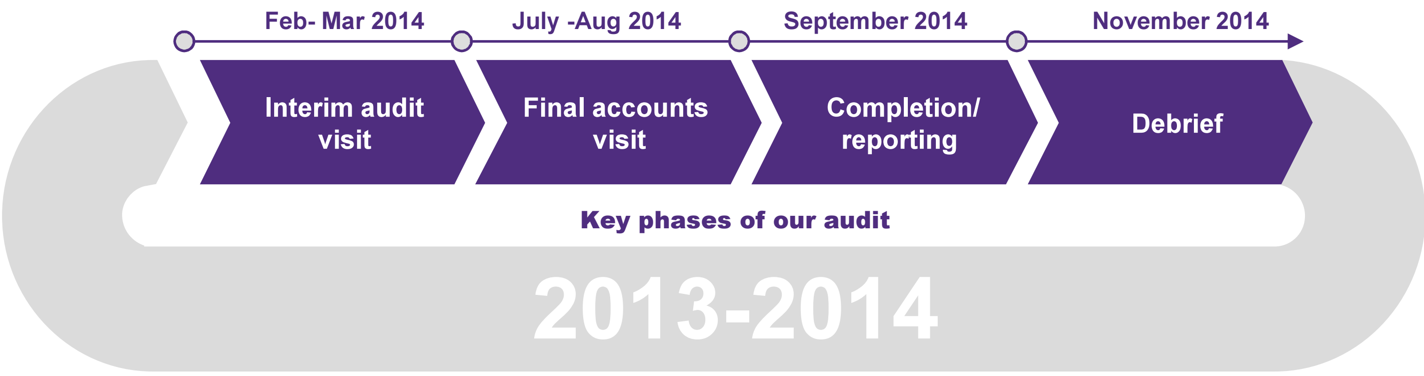
Other risks

The auditor should evaluate the design and determine the implementation of the entity's controls, including relevant control activities, over those risks for which, in the auditor's judgment, it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures (ISA 315).

Other reasonably possible risks	Description	Planned audit procedure
Contributions	Recorded contributions not correct	We will: • perform a test of controls on the Administering Authority's contributions monitoring procedures. • rationalise contributions received with reference to changes in member body payrolls and numbers of contributing pensioners to ensure that any unexpected trends are satisfactorily explained.
Member Data	Member data not correct Regulatory, legal and scheme rules/ requirements not met Actuarial amounts not determined properly	We will • confirm the system of controls and reconciliations covering the determination of member eligibility, the input of evidence into the Pensions Administration System and the maintenance of member records. • substantively test changes to Member Data • examine the reconciliation of membership numbers for each category of member to previous year's figures via retirements, leavers and starters.

Logistics and our team

The audit cycle



Date	Activity
Feb/ March 2014	Planning
Feb/ March 2014	Interim site visit
March 2014	Presentation of the Audit Plan to Audit and Assurance Committee
July - August 2014	Year end fieldwork
September 2014	Audit Findings clearance meeting with Finance staff
September 2014	Presentation of the Audit Findings to Audit and Assurance Committee
September 2014	Opinion issued

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In-charge Executive
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Fees and independence

Fees

	£
Pension Fund (scale fee)	34,169
IAS19 related work	£1,737
Total proposed fee	**£35,906**

Our fee assumptions include:

- Our fees are exclusive of VAT
- Supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- The scope of the audit, and the Pension Fund and its activities have not changed significantly
- The Pension Fund will make available management and accounting staff to help us locate information and to provide explanations

Fees for other services

Service	£
None	Nil

Independence and ethics

Ethical standards and International Standards on Auditing (ISA) 260 require us to give you full and fair disclosure of matters relating to our independence. In this context, we disclose the following to you:

- the in-charge member of our team has a family member who works within the Pension Fund's benefits administration team. To avoid any potential conflicts, this member of our team does not undertake any work on the benefits payable elements of the accounts and is not responsible for the planning or supervision of such work.

We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Full details of all fees charged for audit and non-audit services will be included in our Audit Findings report at the conclusion of the audit.

We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards.

Communication of audit matters with those charged with governance

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

This document, the Audit Plan, outlines our audit strategy and plan to deliver the audit, while the Audit Findings will be issued prior to approval of the financial statements and will present key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

We will communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to those charged with governance.

Respective responsibilities

This plan has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).

We have been appointed as the Council and Pension Fund's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice (the Code) issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Pension Fund's key risks when reaching our conclusions under the Code.

The audit of the Pension Fund's financial statements does not relieve management or those charged with governance of their responsibilities.

Our communication plan	Audit plan	Audit findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issue arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Non compliance with laws and regulations		✓
Expected modifications to the auditor's report, or emphasis of matter		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓

Pension Fund Committee
Meeting to be held on 27 March 2014

Electoral Division affected: All

External Audit
Lancashire County Pension Fund Governance Benchmarking Report
(Appendix 'A' refers)

Contact for further information:
Karen Murray, 0161 234 6364, Director, Grant Thornton
karen.l.murray@uk.gt.com

Executive Summary

Grant Thornton UK LLP have produced a national report on the governance arrangements in place for Local Government Pension Schemes.

The report is based on a detailed survey information from the auditors of 30 Local Government Pension Schemes and covers almost 30% of funds nationally. The survey findings have been followed by more detailed discussions with individual auditors and council officers to understand and identify good practices as well as a desk based review of local government pension scheme websites.

Our findings are supplemented by responses to a higher level survey sent to senior officers managing Local Government Pension Schemes nationally. This survey included questions on your key challenges, skills and capacity and communications with your membership.

With the introduction of LGPS 2014 and the accompanying changes in governance requirements, now is an opportune time for funds to assess their current governance arrangements to ensure they are fit for purpose going forwards.

The areas we have highlighted for pension funds to consider are:
- the effectiveness and scope of current governance structures
- ensuring funds have access to appropriate skills and expertise
- the extent to which investment strategies are kept under review at a strategic level
- the effectiveness of risk management arrangements
- the extent to which administration costs are reviewed
- assurance provided over internal controls.

We have prepared an individual benchmarking report to show how Lancashire Pension Fund compares with others across key indicators of good governance.

Recommendation

The Committee is asked to note the report.

Lancashire County Council

Background and Advice

Attached at Appendix 'A' is the external auditor's Lancashire Local Government Pension Fund Governance Benchmarking report.

The report shows that the arrangements in place for Lancashire County Pension Fund are good in comparison with others in respect of:

- maintaining focus on the investment strategy linked to a view on pension liabilities and an understanding of the factors affecting pensions liabilities,
- effective, focussed, whole fund performance reporting
- investing in officers with appropriate skills to manage the pension fund
- the range and coverage of internal audit work and its reporting through to Pensions Committee
- the use of sub-committees and panels to deal with detailed issues and to facilitate more flexible and responsive decision making.

However, progress compares less well in:

- being relatively late in completing an audit of the skills and knowledge of pension committee members, and in identifying any actions to bridge the gaps. This is linked to the timing of elections and the changes in committee membership
- the partial compliance reported against the governance compliance statement. The Annual Governance Statement of the Council makes no specific reference to the pension fund.

Karen Murray, Engagement Lead, will attend the meeting to present the report and answer any questions.

Consultations

The report has been agreed with the County Treasurer.

Implications

This item has the following implications, as indicated:

Risk management

No significant risks have been identified.

Local Government (Access to Information) Act 1985

List of Background Papers

Paper	Date	Contact/Directorate/Tel
N/A		

Grant Thornton

Appendix 'A'

Introducing Grant Thornton Pension Fund Governance Report and benchmarking data – Lancashire County Pension Fund

November 2013

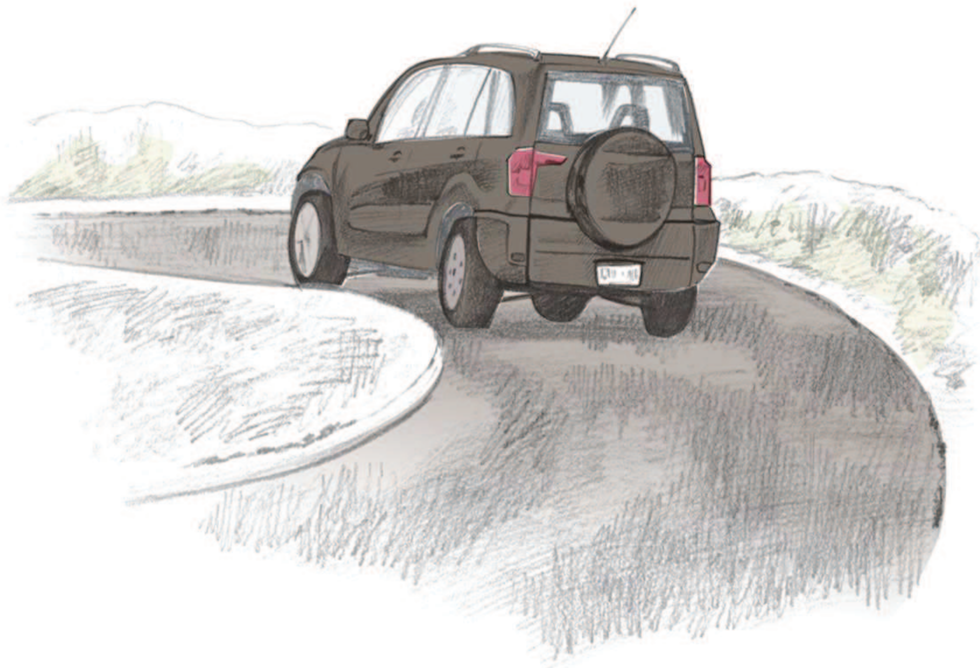
Agenda

Our pension fund experience

National report - themes

Applying your governance in context

Next steps



Our pension fund experience

Pension funds are one of the firm's chosen national sectors, supported by a national pensions panel and dedicated, specialist pension fund teams.

We are the external auditors for 30 of the 99 national local government pension funds

Pension Scheme Accountant of the Year UK Pensions Award Winner 2012

Provide a range of additional services including covenant assessments, advisory support around governance and risk management and investment strategies.

We are also auditors and accountants for over 400 private sector pension funds in the UK

Strong working relationship with the Pensions Regulator

National LGPS Governance Report - themes

The report is based on a detailed survey of our auditors of 30 Local Government Pension Schemes, covering almost 30% of funds nationally. The survey findings have been followed by more detailed discussions with individual auditors and council officers to understand and identify good practices as well as a desk based review of local government pension scheme websites.

Our findings are supplemented by responses to a higher level survey sent to senior officers managing Local Government Pension Schemes nationally. This survey included questions on your key challenges, skills and capacity and communications with your membership.

We have seen many examples across the UK of well managed LGPS Funds. They have been pro-active in reviewing and improving the way in which they work to strengthen governance arrangements and to achieve a more sustainable position for their Fund. However, this is not reflected across all locally administered funds and there is scope for improvement.

With the introduction of LGPS 2014 and the accompanying changes in governance requirements, now is an opportune time for funds to assess their current governance arrangements to ensure they are fit for purpose going forwards.

The areas we have highlighted for pension funds to consider are:

- the effectiveness and scope of current governance structures
- ensuring funds have access to appropriate skills and expertise
- the extent to which investment strategies are kept under review at a strategic level
- the effectiveness of risk management arrangements
- the extent to which administration costs are reviewed
- assurance provided over internal controls.

Annual Report review – themes

Compared to your peers…..

You are doing well in the following areas:

Maintaining a focus on the investment strategy linked to an up- to- date view on pension liabilities and a good understanding of the key factors affecting pension liabilities.

Effective focused whole fund performance reporting

Investment in officer skills recognising the more complex environment within which the pension fund is operating.

Range and coverage of internal audit work and reporting through to the Pension Committee.

Effective use of sub-committees and panels to deal with detailed issues and facilitate more flexible and responsive decision making.

You are among the pack in :

Reviewing and reducing administrative costs through a range of activities including re-tendering services, re-negotiating contracts and removing unnecessary services/reports.

Having a training programme for pension committee members and relevant officers.

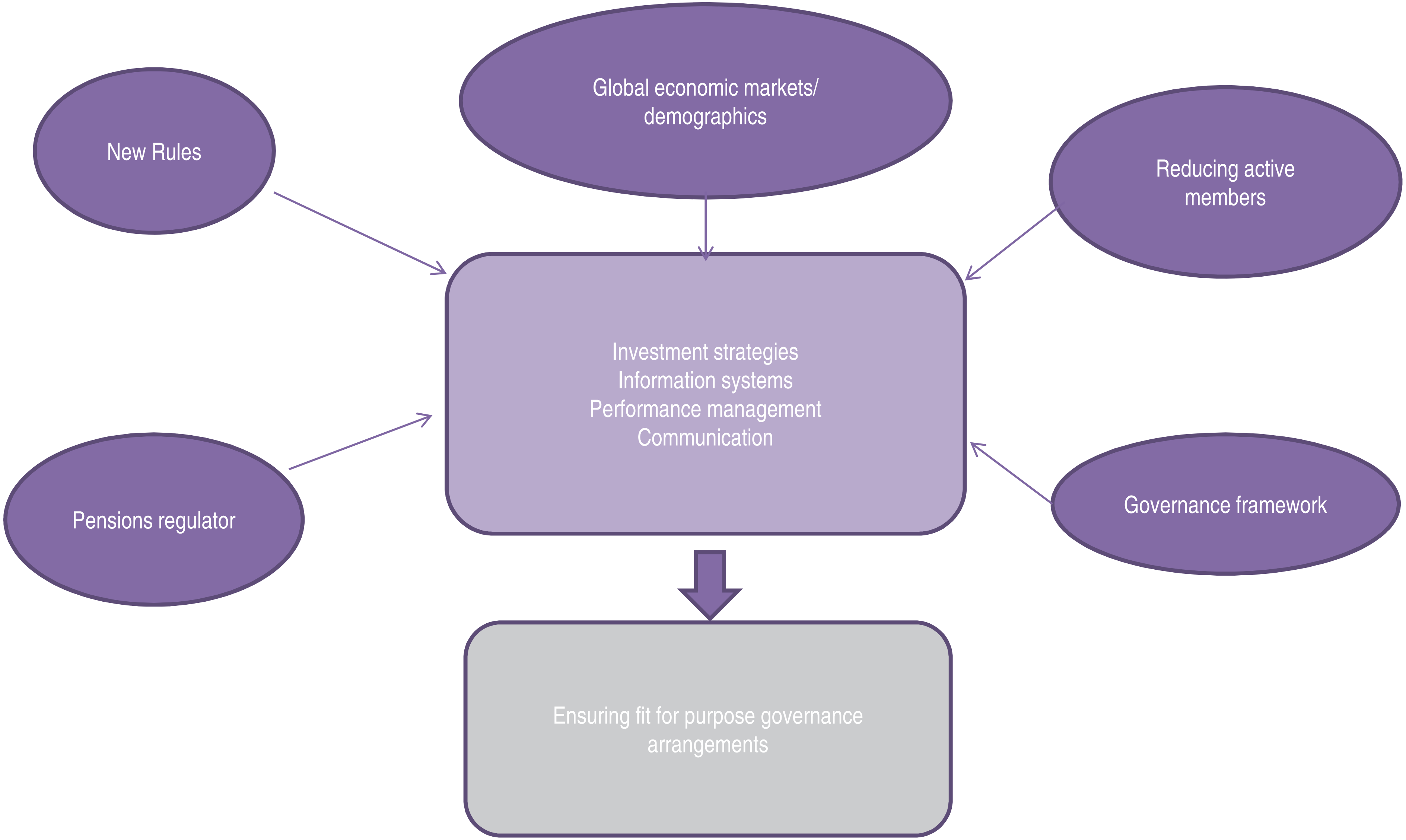
Managing and reporting on risks across the whole activities of the Pension Fund.

You are trailing in the following areas:

The fund is relatively late in completing an audit of skills and knowledge of pension fund members and developing actions to bridge any gaps. This was linked to the timing of LG elections and the resultant change in committee membership.

Partial compliance is reported against the governance compliance statement. Additionally the annual governance statement of the administering authority makes no specific reference to the pension fund.

Applying your governance in context



Where do we go from here?

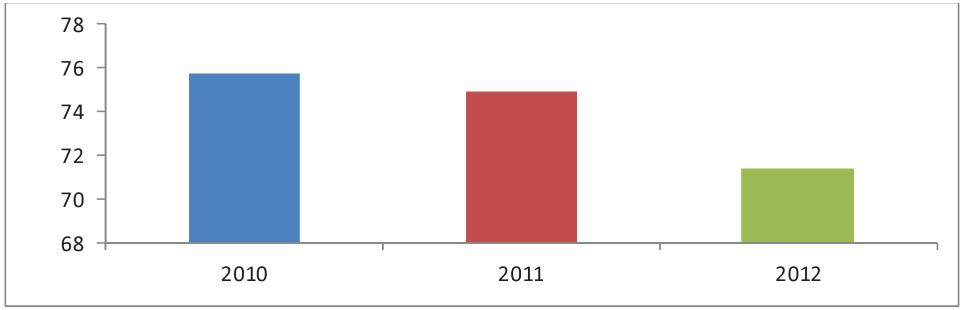
- Current and emerging issues?
- How can we help?
- Questions?

www.grant-thornton.co.uk

Appendix
Your benchmark data

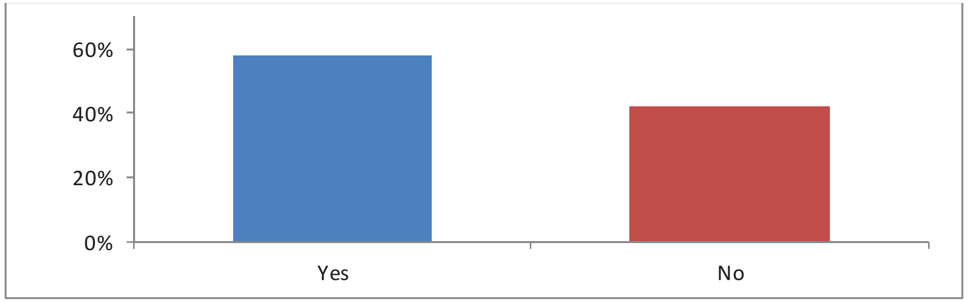
1. What was the reported percentage funding position of your fund as at 31 March?

	%	You
2010	75.69	80
2011	74.88	81
2012	71.38	68



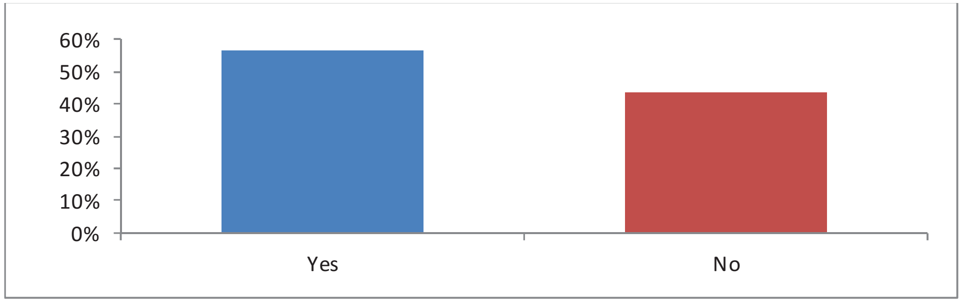
2. In 2011/12 were your funds' total pension contributions sufficient to meet the total pensions payable in the year?

	%	You
Yes	58.1%	
No	41.9%	✓



3. Has your fund made any significant changes to its investment strategy in recent years?

	%	You
Yes	56.7%	✓
No	43.3%	



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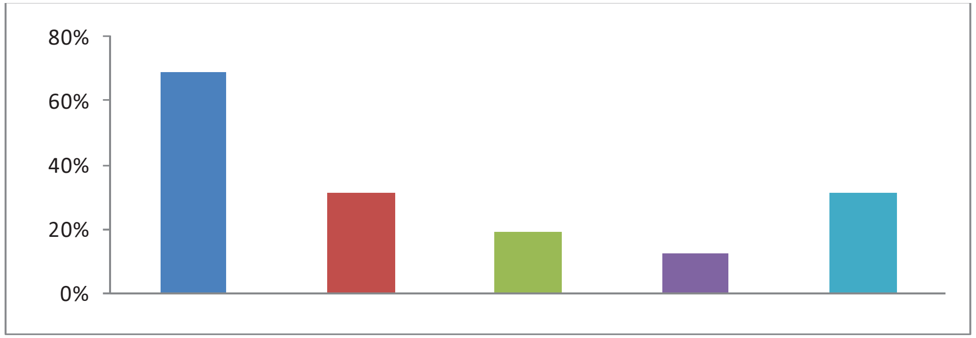
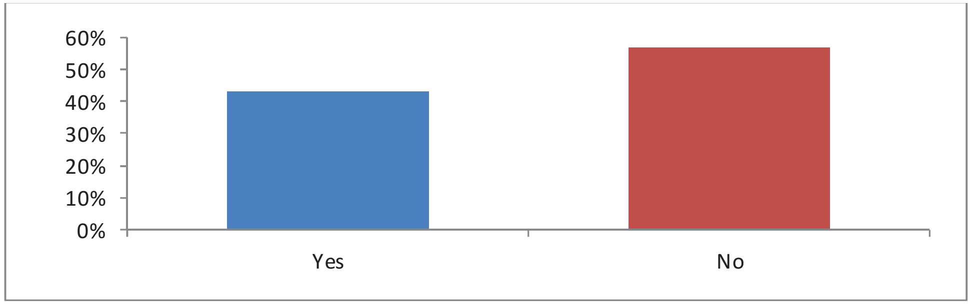
4. What were the key aims of the changes?

	%	You
To reduce volatility	68.8%	✓
To increase investment income	31.3%	✓
To reduce credit risk	18.8%	
To increase liquidity	12.5%	
Other	31.3%	✓



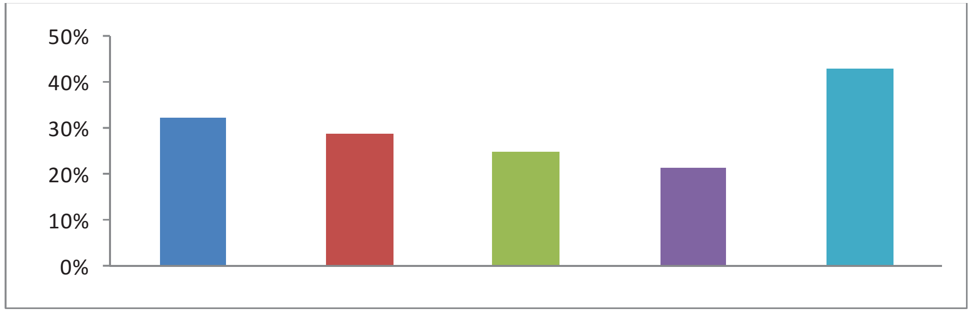
5. Is your fund looking to actively manage the value of its pensions liabilities?

	%	You
Yes	43.3%	✓
No	56.7%	



6. Has your fund taken any action to reduce the administration costs and investment management expenses of the fund?

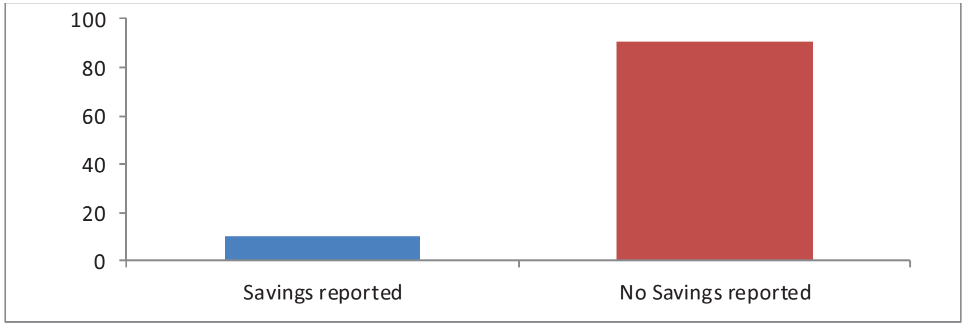
	%	You
Competitive tendering exercises for services	32.1%	✓
Efficiency savings on in-house administrative costs	28.6%	✓
Benchmarking of admin/investment expenses	25.0%	
Other	21.4%	✓
None	42.9%	



7. If your fund has reported on any savings achieved in relation to such actions, what is the level of reported savings?

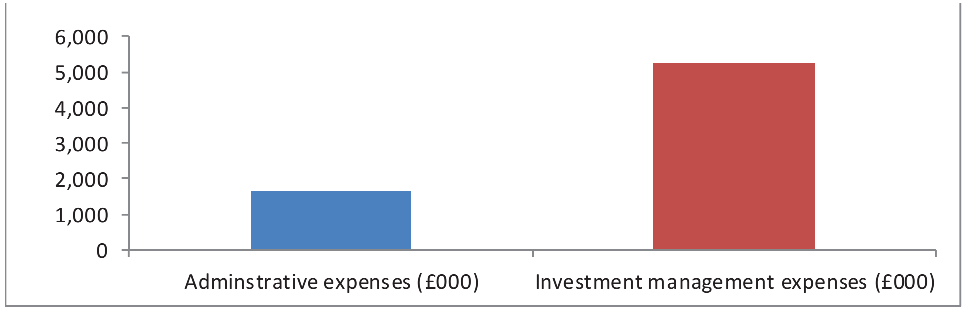
	%	You
Savings reported	9.68	✓
No Savings reported	90.32	

You responded: *'Savings reported: £751,000.'*



8. Please provide below the following costs as reported in your fund's accounts as at 31/3/2012

	Average	You
Adminstrative expenses (£000)	1,633	**3,800**
Investment management expenses (£000)	5,240	**8,300**



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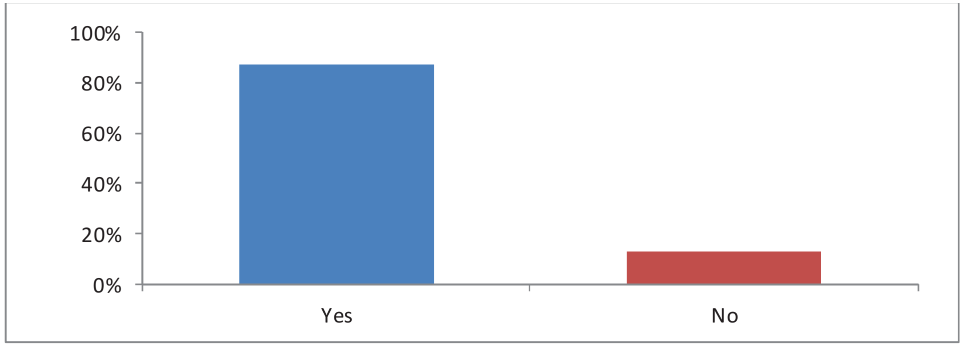
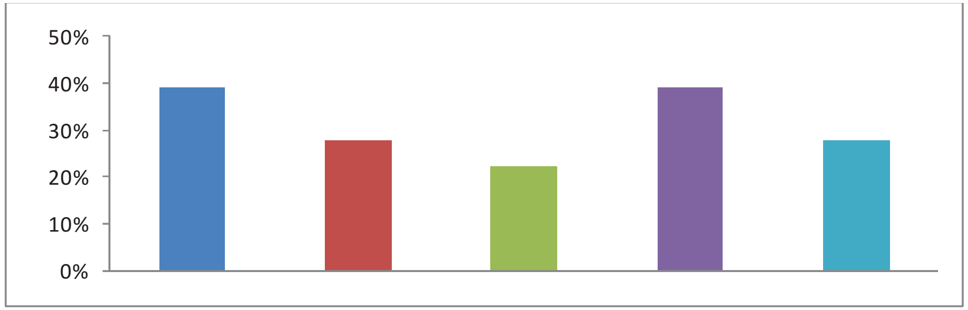
9. CIPFA produced a Code of Practice covering knowledge and skills for practioners and members involved in the management or oversight of pensions funds in September 2011. Did your fund adopt the Code?

	%	You
Yes	87.5%	✓
No	12.5%	



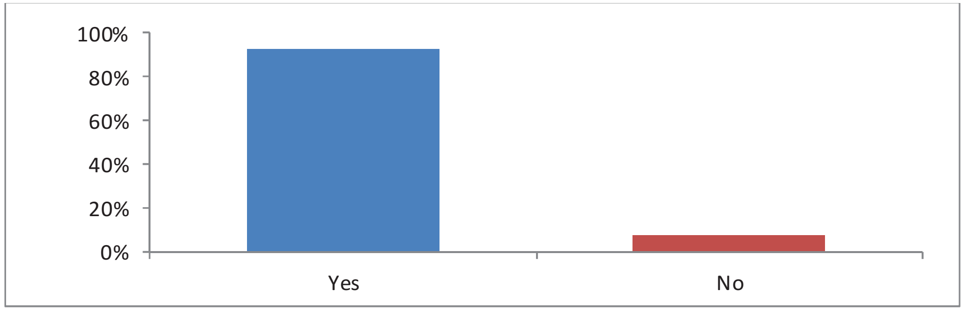
10. Has your fund taken any action in respect of the Code?

	%	You
Completed a self assessment against the framework	38.9%	
Developed a plan to address any gaps identified	27.8%	
Implemented/implementing such a plan	22.2%	
Other	38.9%	
None	27.8%	✓



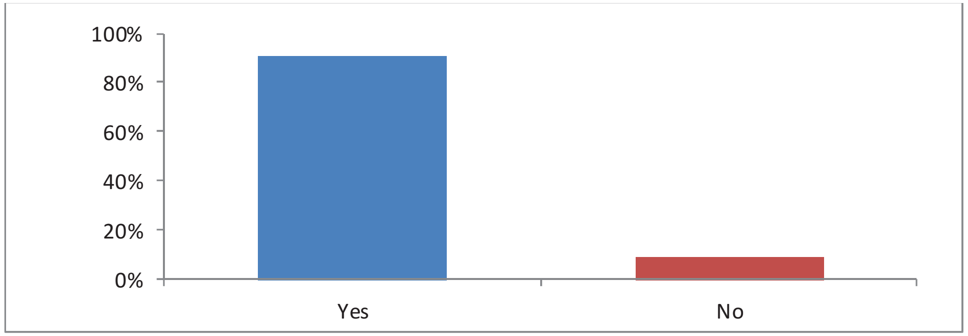
11. Does your fund have a training programme for members of its pension fund committee?

	%	You
Yes	92.6%	✓
No	7.4%	



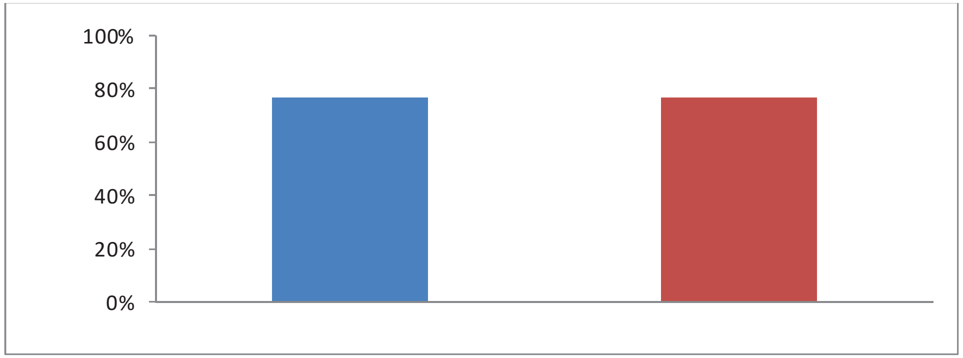
12. Does your fund have a programme of continuing professional development in respect of pension fund issues for officers involved in the management of the fund?

	%	You
Yes	90.9%	✓
No	9.1%	



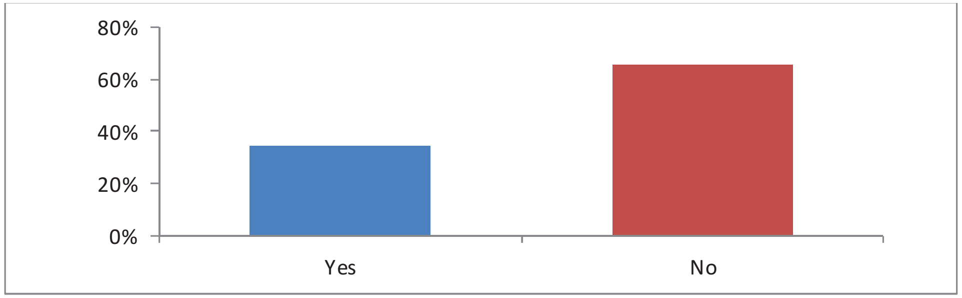
13. If your fund has made significant changes to its investment strategy or in respect of liability management, has it:

	%	You
Considered the impact on the skills needed by relevant officers and members?	76.9%	✓
Considered the need to bring in additional capacity through the use of advisors and consultants?	76.9%	✓



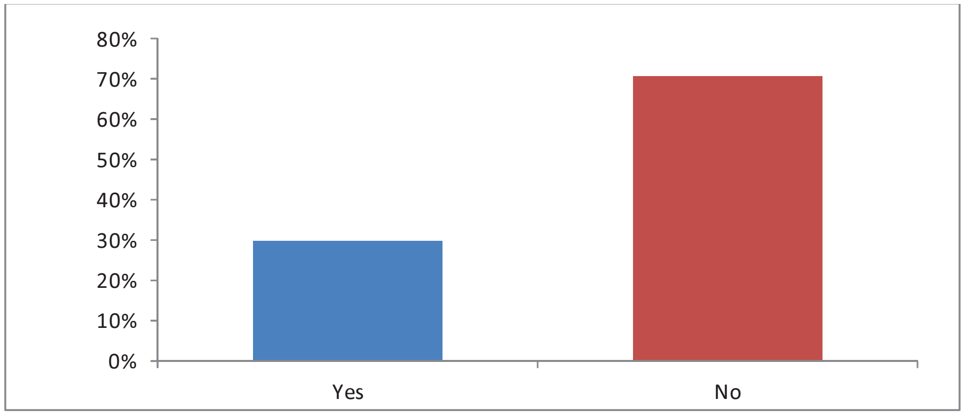
14. Has your fund reported any aspect of partial or non-compliance with the expected governance requirements within its governance compliance statement?

	%	You
Yes	34.5%	✓
No	65.5%	



15. The annual governance statement (AGS) of administering authorities sets out how the responsiblle officers obtain assurance around the overall governance of the organisation and whether there are any specific issues therein which need to be addressed. Does the AGS for your administering authority make any specific references to the pension fund?

	%	You
Yes	29.6%	
No	70.4%	✓



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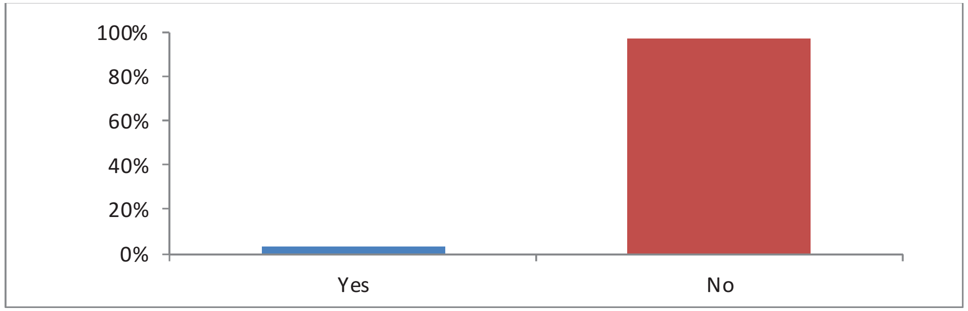
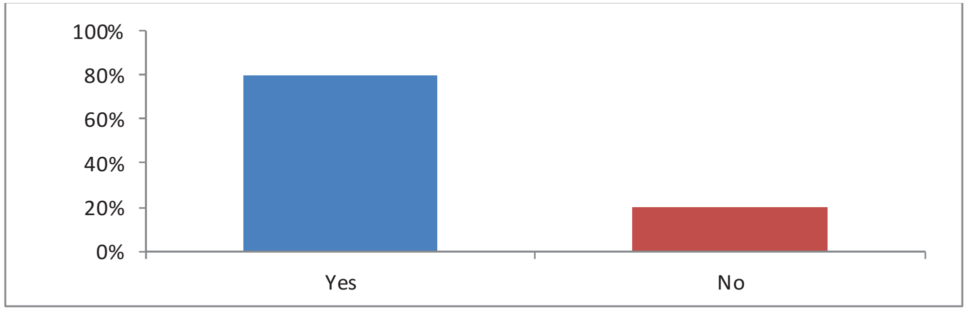
16. Does your fund produce a separate AGS for the pension fund?

	%	You
Yes	3.4%	
No	96.6%	✓



17. Does your fund consider and report on the management of the key risks affecting the pension fund?

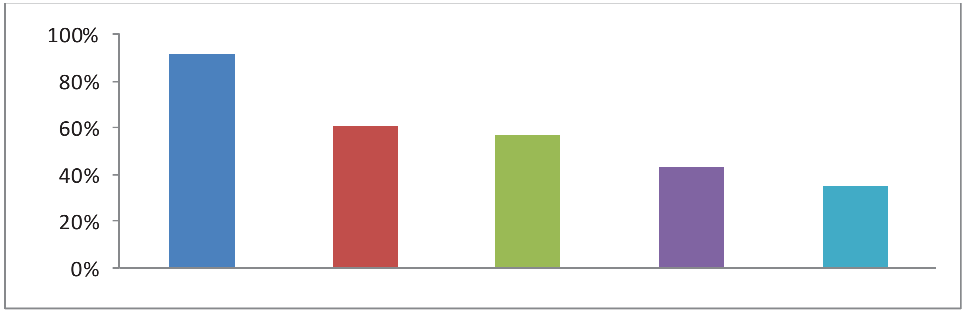
	%	You
Yes	80%	✓
No	20%	



18. Please tick all aspects listed below which are included in those considerations.

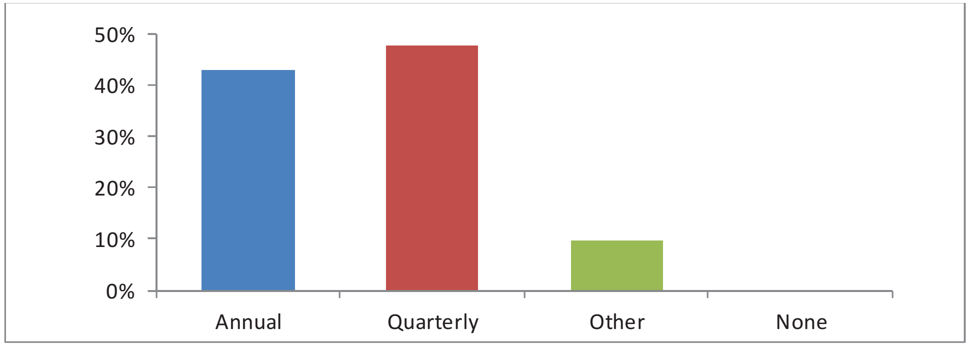
	%	You
Investment risks	91.3%	✓
Liability risks	60.9%	✓
Pensions administration risks	56.5%	✓
Processes/controls risks	43.5%	✓
Other	34.8%	✓

You responded: *'Cash flow, credit risk, liquidity risks.'*



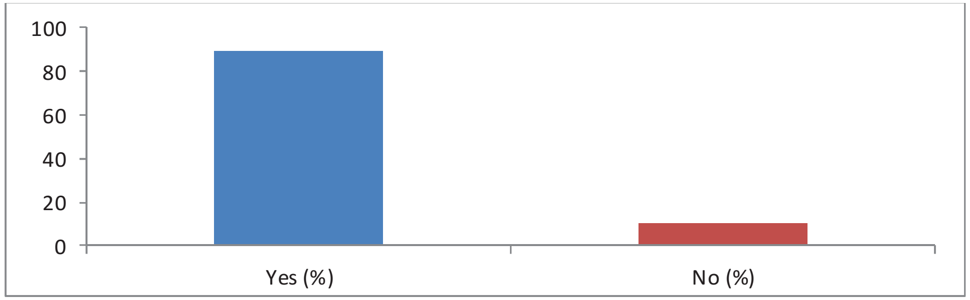
19. Is there regular reporting to members?

	%	You
Annual	42.9%	
Quarterly	47.6%	✓
Other	9.5%	
None	0%	

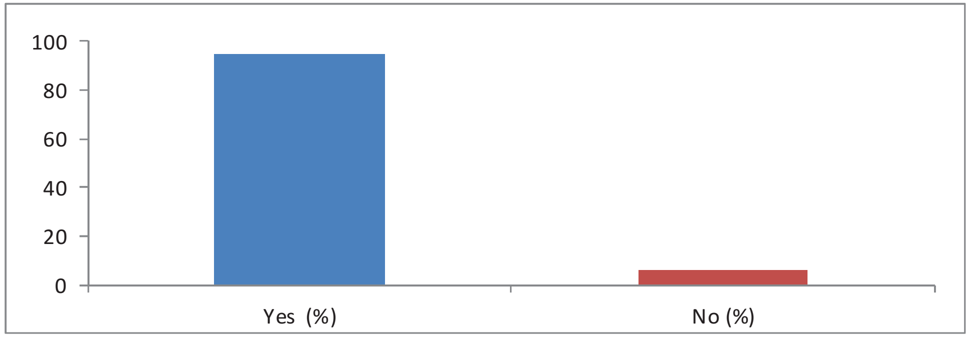


20. Does such reporting (if carried out) clearly identify;

	Yes (%)	No (%)
The nature and scale of the risks?	89.47	10.53
You:	✓	



	Yes (%)	No (%)
The action being taken to manage/control the risks?	94.44	5.56
You:	✓	



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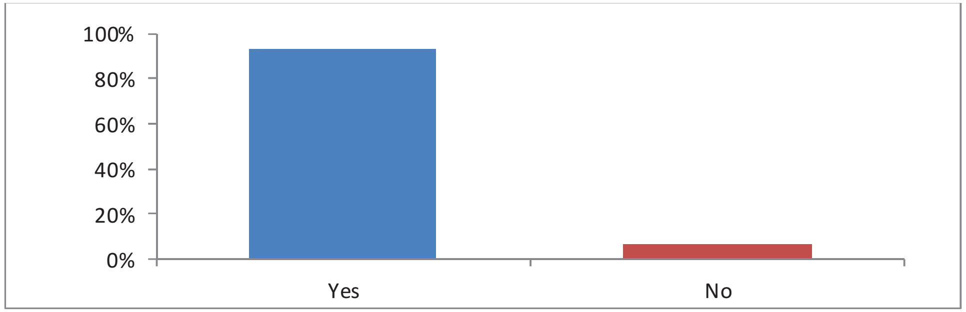
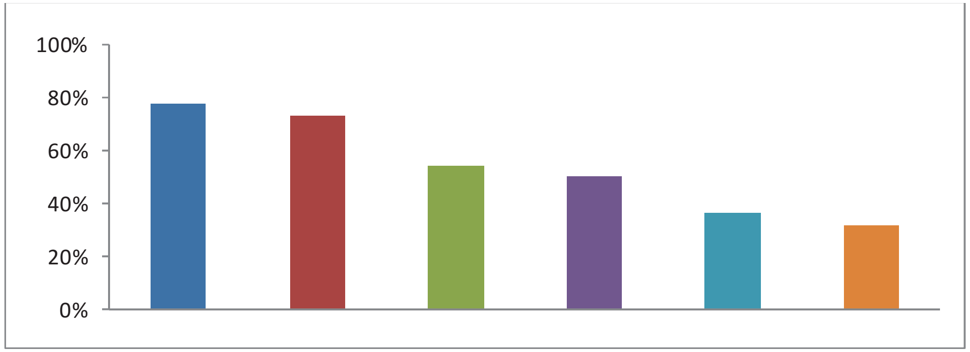
21. Does internal audit's programme of work include work on the pension fund?

	%	You
Yes	93.3%	✓
No	6.7%	



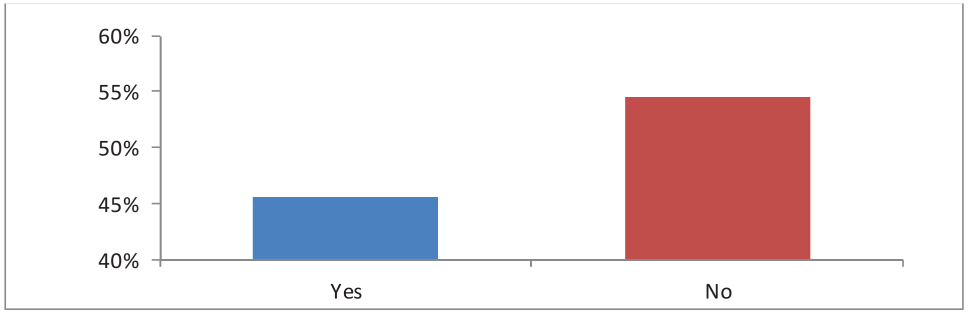
22. Please tick all the relevant boxes below which are relevant to their work over the last three years:

	%	You
Pensions payments	77.3%	✓
Contributions	72.7%	X
Investments	54.5%	✓
Expenses	50.0%	✓
Tendering of contracts	36.4%	✓
Other	31.8%	X



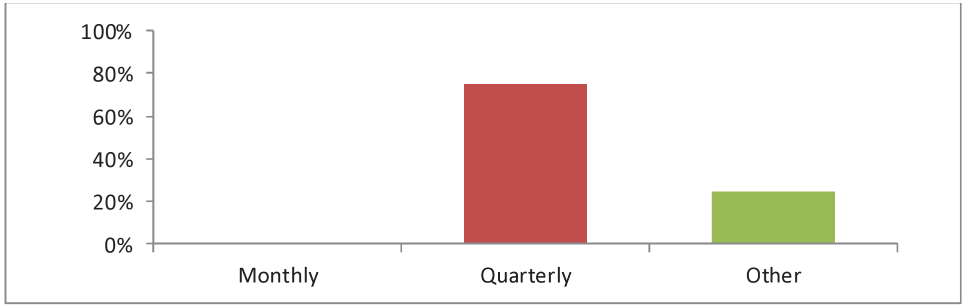
23. Where internal audit completes specific work on the pension fund, do they report their plan and the outcome of their work to the pension fund committee?

	%	You
Yes	45.5%	✓
No	54.5%	



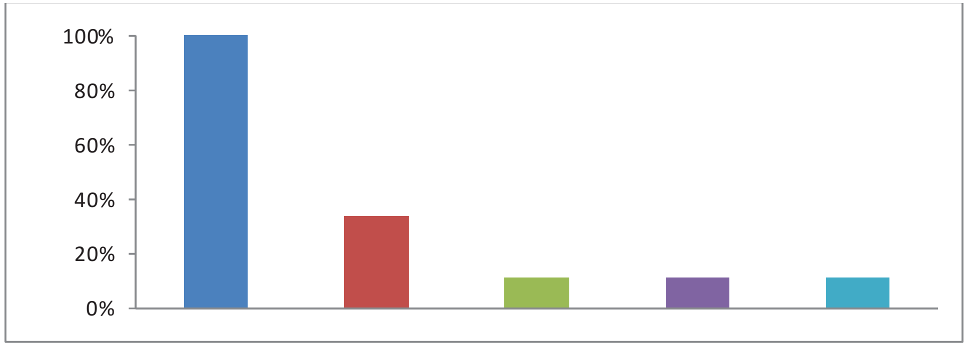
24. How often does the pension fund committee meet?

	%	You
Monthly	0%	
Quarterly	75%	✓
Other	25%	



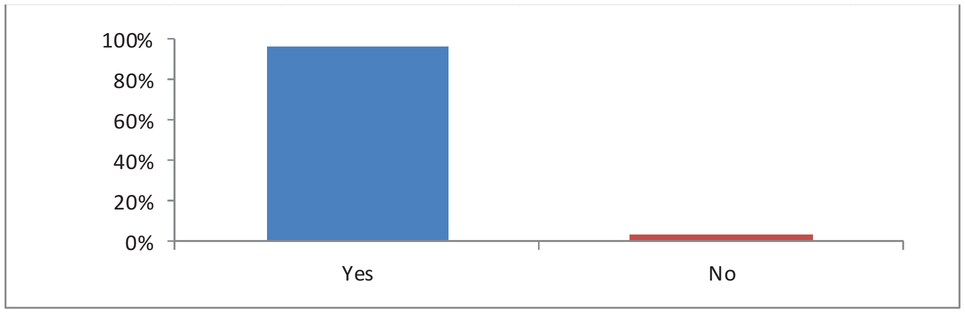
25. If your pensions committee operates with sub-committees and/or panels, please list below with a brief description of their function if not explicit from their title.

	%	You
1 Sub-committee/Panel	100.0%	
2 Sub-committees/Panels	33.3%	✓
3 Sub-committees/Panels	11.1%	
4 Sub-committees/Panels	11.1%	
5 Sub-committees/Panels	11.1%	



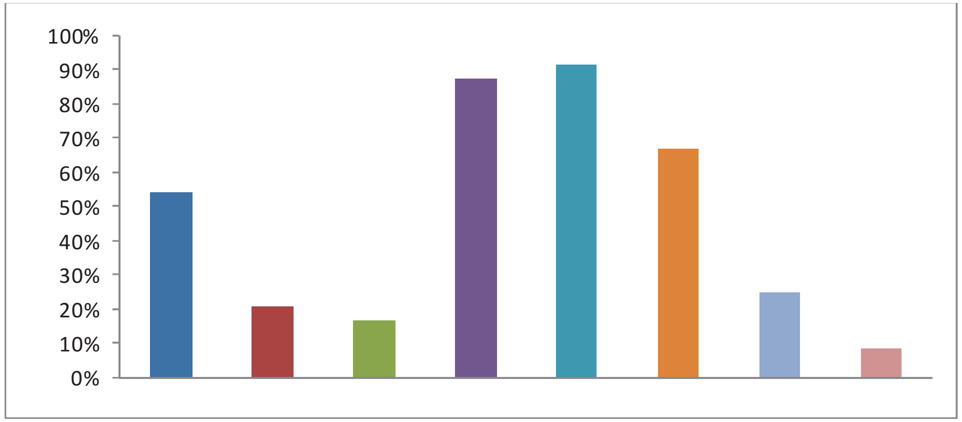
26. Does your pension committee receive a performance report at each meeting?

	%	You
Yes	96.3%	✓
No	3.7%	



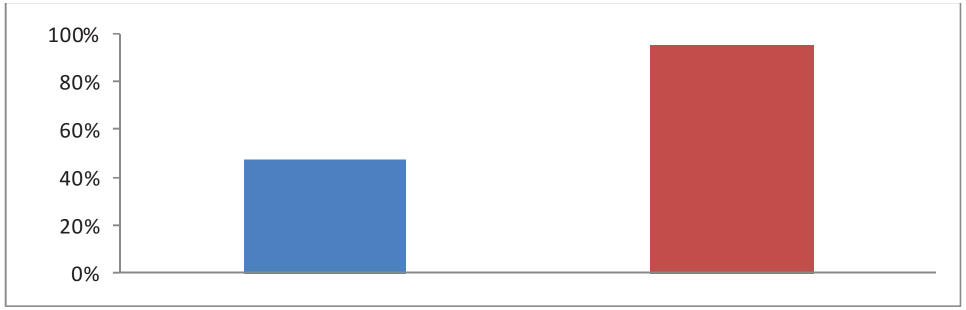
27. Please tick all relevant boxes below regarding coverage:

	%	You
Funding level	54.2%	✓
Cash flow	20.8%	✓
Liabilities	16.7%	✓
Investment performance	87.5%	✓
Fund manager performance	91.7%	✓
Investment allocation v strategy	66.7%	✓
Risk management	25.0%	✓
Other	8.3%	X



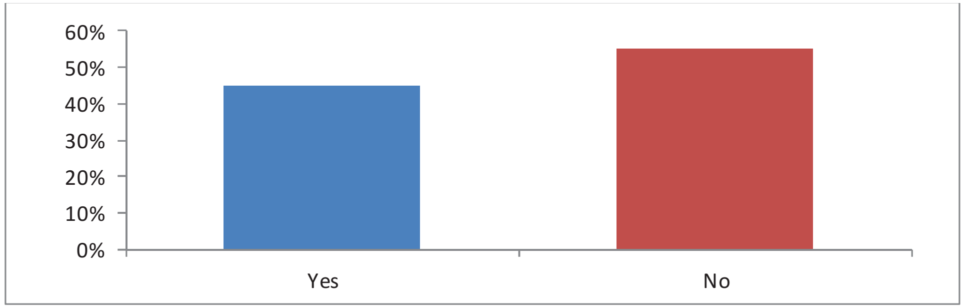
28. Does the committee also receive regular reports covering:

	%	You
Pensions administration performance against targets?	47.6%	✓
Key investment decisions?	95.2%	✓



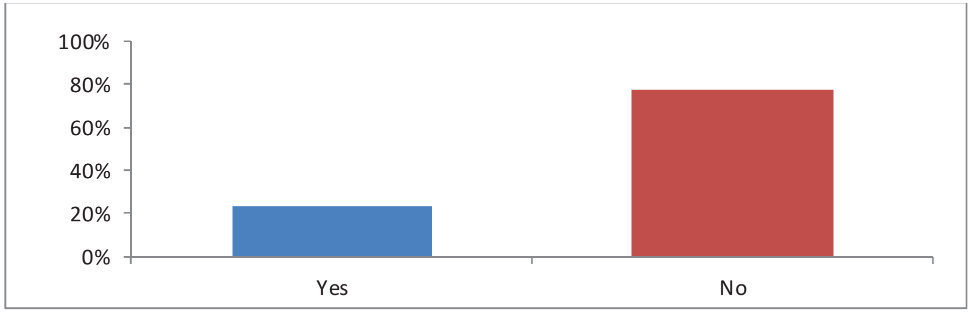
29. Has the committee reviewed the way in which it works in recent years and if so what changes have been made as a result?

	%	You
Yes	45%	✓
No	55%	



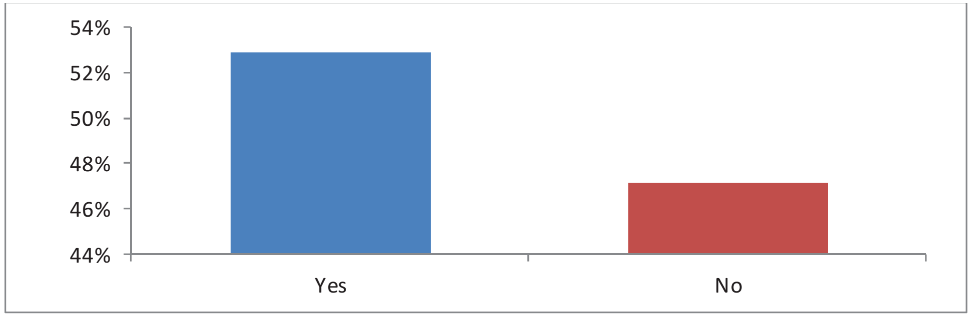
30. Does the committee produce an annual report of its work during the year?

	%	You
Yes	22.7%	
No	77.3%	✓



31. Has the committee considered the usefulness of the information it receives to support their work and made any changes? If so please provide brief details below.

	%	You
Yes	52.9%	✓
No	47.1%	



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