Lancashire County Council

Pension Fund Committee

Friday, 15th April, 2011 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 Personal and Prejudicial Interests** Members are asked to consider any Personal/Prejudicial 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 4 February 2011** To be confirmed, and signed by the chair.	(Pages 1 - 6)
4.	**Audit Commission - Lancashire Pension Fund 2010/11 External Audit Plan**	(Pages 7 - 32)
5.	**Internal Audit Plan 2011/12**	(Pages 33 - 38)
6.	**The Operation of the Investment Panel - Investment Decision Making**	(Pages 39 - 44)
7.	**Revised Governance Arrangements**	(Pages 45 - 54)
8.	**Pension Fund Treasury Management Policy and Strategy 2011/12**	(Pages 55 - 62)
9.	**Appointment of Consultancy Bench**	(Pages 63 - 66)
10.	**Report of the Independent Public Service Pensions Commission**	(Pages 67 - 74)
11.	**Transaction of Urgent Business**	(Pages 75 - 76)

Lancashire County Council

12. 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.

13. Date of Next Meeting

The next meeting of the Committee will be held on Friday 15 July 2011 at 10.00am at County Hall, Preston.

14. Exclusion of Press and Public

The Cabinet 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)

15. Global Custody (Pages 77 - 88)

(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972.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).

16. Report of the Investment Panel (Pages 89 - 102)

(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).

17. Review of Hedge Fund of Fund Managers (Pages 103 - 106)

(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).

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Lancashire County Council

Pension Fund Committee

Minutes of the Meeting held on Friday, 4th February, 2011 at 10.00 am in Cabinet Room 'C' - County Hall, Preston

Present:

County Councillor David Westley (Chair)

County Councillors

T Aldridge	M Parkinson
M Barron	T Pimblett
M Brindle	S Riches
P Evans	G Roper
M France	M Welsh
F De Molfetta	K Young

Co-opted members

P Doyle	(Lancashire Leaders' Group respresentative)
P Goldsworthy	(Lancashire Leaders' Group respresentative)
B Harvey	(Trade Union representative)
P Hyett	(HE/FE Sector Establishments respresentative)
R Whittle	(Trade Union representative)

Independent Advisers - Panel Members:

E Lambert	N Mills

1. Apologies

Apologies for absence were presented on behalf of County Councillor J Lawrenson.

2. Disclosure of Personal and Prejudicial Interests

The following members of the Committee disclosed personal non-prejudicial interests in this agenda as they were members of the Local Government Pension Scheme:

M Brindle	P Evans
M France	R Harvey
P Hyett	T Pimblett
D Westley	R Whittle

3. Minutes of the Meeting held on 10 December 2010

The minutes of the meeting held on 16 July 2010 were presented.

It was noted that County Councillor K Young had attended the meeting held on 16 July 2010 and that Mr R Whittle had disclosed a personal non-prejudicial interests in the agenda for the meeting as he was a member of the Local Government pension Scheme. Unfortunately this information had been omitted from the minutes now presented and it was agreed that the minutes should be amended accordingly.

Resolved: That, subject to the above-mentioned amendments, the minutes of the meeting held on 16 July 2010 be confirmed and signed by the chair.

4. Principles of Revised Governance Arrangements

The Committee considered a report on proposals to amend the Pension Fund's decision making and governance arrangements.

The purpose of the report was to invite comments on a range of proposals to support the new ways of working required by the revised investment strategy that was approved by the Committee on 10 December 2010. The views of the Committee were sought on the following issues:

- Investment decision making – the revised investment strategy required the Fund to make a wider range of individual investment decisions, rather than simply placing funds with managers. It was proposed that the Treasurer to the Fund be given delegated authority to make individual investments on the recommendation of the Investment Panel with the two independent advisers having a veto against a particular investment. This mirrored the arrangements for the Fund's property transactions.

- Procurement arrangements – the committee would determine the criteria for the award of a contract and the Treasurer would be given delegated authority to award the contract on the advice of the Investment Panel. Whilst this proposal would result in the disestablishment of the standing Appointments Sub-Committee, an ad hoc sub-committee would need to be convened to oversee the appointment of the two independent advisers.

- An enhancement of the requirement that the Investment Panel reports on its decisions to each meeting of the Committee.

- The composition of the Committee to remain unchanged.

- The future role of the Administration Sub-Committee.

Members raised a number of comments on the proposals and the main points are summarised below:

- Concerns were expressed about the accountability of the proposed new investment decision making arrangements and the lack of member involvement. It was suggested that the Chair of the Committee (or in his/her absence the Deputy Chair) should serve on the Investment Panel.

  Members were assured that the proposal was no different than the other mandates which had been approved by the Committee. All investment decisions must comply with the new investment strategy and no decisions would be taken without the support of the independent advisers. The Committee would receive a report on the investment decisions taken and the rationale for them at each meeting. This would enable members to review, monitor and challenge the decisions taken in line with existing process.

  It was agreed that further clarification on the proposed new investment arrangements including the decision making process and accountability should be presented to the next meeting of the Committee.

- A concern was expressed that members would not be involved in the procurement decision making phase.

  Members were informed that the current arrangement of the Appointments Sub-Committee making the decision on final selection brought members in to the process at the wrong point. It would be very difficult for members to reject a recommendation which had been borne out of a selection process which met EU procurement rules. It was felt that Members would be better involved at an earlier stage in agreeing the criteria for the award of a contract. The earlier suggestion that the Chair of the Committee should be appointed to the Investment Panel would also provide member involvement in any recommendations to the Treasurer.

- It was considered that the standing Appointments Sub-Committee should be disestablished and that an hoc sub-committee be established as and when necessary for the purpose of overseeing the appointment of the two independent advisers.

- Whilst it was acknowledged that the composition of the Pension Fund Committee met the current regulatory framework, there was a need for the Committee to be representative of the Fund's membership and changes to the composition of the committee should be considered in light of any revised guidance.

- It was considered that the Administration Sub-Committee should be retained and that the Sub-Committee should be requested to specifically monitor the running of the Fund and examine how a greater take-up of the local government pension scheme could be achieved.

Resolved:

1. That the standing Appointments Sub-Committee be disestablished and that an ad hoc sub-committee be convened as and when necessary for the purpose of appointing the independent advisers to the pension Fund Committee.

2. That the Chair of the Committee and in his/her absence the Deputy Chair be appointed to serve on the Investment Panel.

3. That no changes be made to the Committee's membership.

4. That the Administration Sub-Committee be retained.

5. That the County Secretary and Solicitor be requested to prepare a new "constitution" for the Lancashire County Pension Fund reflecting the decisions at 1 to 4 above, the points raised at the meeting and the proposals set out in the report now presented including clarification of the new Investment Decision Making process and accountability.

6. That the new "constitution" be presented to a future meeting of the Committee.

5. Lancashire County Pension Fund - Business Plan 2011/12

The Committee considered the proposed Business Plan for 2011/12.

Work over the coming year would focus on the implementation of the new investment strategy and would include:

- revising governance arrangements
- creating a new investment team
- designing and implementing new processes
- transition between existing arrangements and new arrangements
- review and procurement of various fund manager mandates

A copy of the Plan was presented at Appendix 'A'. This reflected the rolling forward of ongoing activity for 2010/11 and the progress made to date with specific projects included in the 2011/12 Plan.

The Committee noted that there would continue to be a considerable workload associated with the administration of the Fund. This included the implementation a new pensioner payroll system integrated with the pensions administration system.

It was confirmed that the creation of a separate bank account for the Pension Fund was on-going and that the internal audit service was happy with progress. It was also confirmed that arrangements were in hand to satisfy audit requirements around the valuation of private equity investments.

Resolved: That the proposed Business Plan for 2011/12 be approved.

6. Revised Funding Strategy Statement

The Committee considered the Fund's revised Funding Strategy Statement which followed the results of the 2010 formal actuarial valuation of the Fund as noted by the Committee on 10 December 2010.

It was noted that the proposed Funding Strategy Statement had been communicated to employers at the Directors Briefing held on 14 December 2010 and consultation was underway with individual Fund employers in respect of their individual employer contribution rates and the options available to them via the revised Funding Strategy Statement.

The Committee's attention was particularly drawn to Section 5 of the Funding Strategy Statement which set out the deficit recovery plan. Members were asked to agree that the Treasurer to the Lancashire County Pension Fund be authorised to use her discretion where an individual employer wished to deviate from the deficit recovery plan as set out within the revised Funding Strategy Statement, subject to any deviation not impacting on the overall prudent management of the Fund. Such action would only be taken in exceptional circumstances and details would be reported to the Committee.

It was agreed that the Committee need to strengthen its monitoring of investment activity against performance targets, as well as risk management issues. A report on these matters would be presented to each meeting of the Committee.

Resolved:

1. That the revised Funding Strategy Statement be approved.

2. That the Treasurer to the Lancashire County Pension Fund be authorised to use her discretion in exceptional circumstances where an individual employer wishes to deviate from the deficit recovery plan as set out within the revised Funding Strategy Statement, subject to any deviation not impacting on the overall prudent management of the Fund.

3. That a report on any actions taken under 2. above be presented to the subsequent meeting of the Committee.

7. Procurement of Actuarial Services

The Committee received an update on the procurement of actuarial services on behalf of the Fund.

A tripartite exercise to tender for actuarial services began on 18 January 2011. The arrangement was between the Lancashire County Pension Fund, the Cumbria Pension Fund and Merseyside Pension Fund with Merseyside acting as the lead authority during the procurement process.

Details of the process and timescale were set out in the report. It was noted that each Authority would meet on or around 1 July to consider the results of the procurement exercise and to appoint the same recommended provider. Separate contracts would be entered into by each Authority.

Resolved: That the process and timescale of the procurement exercise for actuarial services on behalf of the Fund be noted.

8. Date of Next Meeting

It was noted that the next meeting of the Lancashire Pension Fund Committee would be held on Friday 15 April 2011 at 10.00am at County Hall, Preston.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Agenda Item 4

Pensions Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected: None

Audit Commission – Lancashire Pension Fund 2010/11 External Audit Plan
(Appendix 'A' refers)

Contact for further information:
Fiona Blatcher, 0844 798 7056, Audit Commission,
f-blatcher@audit-commission.gov.uk

Executive Summary

In July 2010, the Pension Fund Committee received the fee letter for the audit of the Pension Fund for 2010/11. Since then, the 2009-10 audit has been completed and a detailed audit plan has now been produced setting out in particular the key audit risks for 2010/11 and the planned audit strategy.

The plan at Appendix 'A', sets out the audit work the Audit Commission propose to undertake in relation to the audit of financial statements 2010/11 for Lancashire Pension Fund. The plan is based on the Audit Commission's risk-based approach to audit planning which assesses:

- current national risks relevant to your local circumstances; and
- your local risks and improvement priorities.

Recommendation

The Committee is asked to note the Audit Commission's report.

Background and Advice

The plan includes a summary of the key risks for the financial statements identified through audit risk assessment process together with the auditor's planned response.

This plan and any reports arising from the audit will also be discussed with the Audit Committee. As the pension fund accounts remain part of the financial statements of Lancashire County Council as a whole, the Audit Committee will retain ultimate responsibility for receiving, considering and agreeing the audit plans, as well as receiving and considering any reports arising from the audit. This plan was presented to the Council's Audit Committee on 24 January 2011.

Clive Portman, District Auditor, will attend the meeting to present the report and respond to questions.

Lancashire County Council

Consultations

This report has been shared with the Treasurer to the Pension Fund, Pensions Fund Manager and Pensions Fund senior accountant.

Implications:

N/A

Risk management

No significant risk management implications have been identified.

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

Paper	Date	Contact/Directorate/Tel
Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies		Fiona Blatcher Audit Commission 0844 798 7056
Audit Commission Act 1998		
Code of Audit Practice		

Reason for inclusion in Part II, if appropriate

N/A

Audit opinion plan

Lancashire Pension Fund

Audit 2010/11

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

Contents

Introduction

This plan sets out the audit work that I propose to undertake for the audit of financial statements of the pension fund.

1 The plan is based on the Audit Commission's risk-based approach to audit planning, which assesses:

- current national risks relevant to your local circumstances; and
- your local risks.

2 I will discuss and agree this plan, and any reports arising from the audit, with the Pension Fund Committee. However, as the pension fund accounts remain part of the financial statements of Lancashire County Council as a whole, the Audit Committee will retain ultimate responsibility for receiving, considering and agreeing the audit plans, as well as receiving and considering any reports arising from the audit.

Responsibilities

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out the respective responsibilities of the auditor and the audited body. The Audit Commission has issued a copy of the Statement to every audited body.

3 The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet my responsibilities.

4 I comply with the statutory requirements governing our audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice.

5 Specifically, the work of auditors on pension fund accounts is defined by the Auditing Practices Board practice note 15 on the audit of pension fund accounts.

Fee for the audit

The indicative fee for the audit is £61,795, as noted in my letter of 7 June 2010.

6 The Audit Commission scale fee for Lancashire Pension Fund is £49,437. The fee proposed for 2010/11 is 25 per cent above the scale fee and is within the normal level of variation specified by the Commission.

7 In setting the fee, I have assumed that:

- the level of risk in relation to the audit of accounts is consistent with that for 2009/10;
- good quality, accurate working papers are available at the start of the financial statements audit; and.
- Internal Audit undertakes appropriate work on all material systems and this is available for our review by 30 April 2011.

8 Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee. Where this is the case, I will discuss this first with the Treasurer of the Pension Fund and I will issue supplements to the plan to record any revisions to the risk and the impact on the fee.

9 Further information on the basis for the fee is set out in Appendix 1.

Specific actions Lancashire Pension Fund could take to reduce its audit fees

10 The Audit Commission requires its auditors to inform audited bodies of specific actions it could take to reduce its audit fees. As in previous years, I will work with staff to identify any specific actions that the Pension Fund could take and to provide ongoing audit support.

11 Specific actions already noted during 2010 include the effective operation of a separate bank account for the pension fund and ensuring all fund managers can provide independent confirmation of their controls over processing and valuation. Action is already in hand to have a separate bank account from April 2011.

12 A report to the Pension Fund Committee on 10 December set out proposed changes to the Fund's Investment Strategy going forwards. These will have a significant impact on the nature of the investment portfolio and its management going forwards. Such changes are likely to increase the audit procedures needed in future and could therefore result in increased audit fees. We will work with staff to understand the detailed changes and identify any specific actions around these changes that could help to lessen the impact on audit fees.

Auditors report on the financial statements

I will carry out the audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB).

13 I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view of the financial position of the Pension Fund as at 31 March 2011.

14 I am also required to review the pension fund annual report according to the LGPS regulations 1997.

Materiality

15 I will apply the concept of materiality in both planning and performing the audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

Identifying opinion audit risks

16 I need to understand fully the audited body to identify any risk of material misstatement (whether due to fraud or error) in the financial statements. I do this by:

- identifying the business risks facing the Pension Fund, including assessing your own risk management arrangements;
- considering the financial performance of the Pension Fund;
- assessing internal control - including reviewing the control environment, the IT control environment and Internal Audit; and
- assessing the risk of material misstatement arising from the activities and controls within the Pension Fund information systems.

Identification of specific risks

I have considered the additional risks that are appropriate to the current opinion audit and have set these out below.

Table 1: **Specific risks**

Specific opinion risks identified

Risk area	Audit response
Implementation of International Financial Reporting Standards (IFRS). This requires disclosure in the pension fund accounts of future pension liabilities as well as current liabilities. This will require liaison with the actuary to ensure sufficient and appropriate information is available to meet the requirements. Actuarial estimates involve a wide range of uncertainty because of the variety and range of assumptions made within the estimation process.	We will: ■ review the information provided to the actuary by the Pension Fund to support their estimation process; ■ obtain independent expert advice on our ability to rely on the actuaries estimates; and ■ ensure the actuarial information is shown correctly in the financial statements.
Changes in key staff. This increases the inherent risk of material error or non-compliance with accounting standards within the Pension Fund financial statements.	Standard audit procedures on the whole should be sufficient to cover this risk including a detailed early review of the draft financial statements. In addition we will increase the level of sample testing we will undertake on individual items of account.

Risk area	Audit response
Pensions administration. During 2010/11 a new financial system for calculating and paying pensions has been implemented. The Pensions team has also been dealing with increased workloads following the implementation of redundancy/early retirement programmes of admitted bodies. These changes both increase the inherent risk of material error in pension payments and could also impact on the accuracy of information provided to the actuary.	We will: ▪ plan to rely on the work of internal audit around introducing the new pensions system; ▪ review the management controls in place to ensure the various changes have not resulted in a significant weakening in pensions processing ▪ carry out tests of detail on the accuracy of pension calculations and processing during the year including carrying our predictive analytical review procedures.
Private Equity, (PE) Investment Values. The pension fund has over £100 million invested in private equity funds. These are not traded on an open market and therefore their valuations are estimated by the private equity fund operators. The Pension Fund have agreed to complete more detailed checking of these valuations following recognised industry guidance for 2010/11. As the Pension Fund investment strategy is developing there may be an increase in other more complex investment instruments during 2010/11.	We will review the actions taken by the Pension Fund to gain assurance about the valuations provided and plan to place reliance on these controls if possible. If this does not provide sufficient assurance we will complete sample testing of PE values by reference to audited accounts and communications with relevant auditors of the Funds. Should other more complex investments have become more significant in 2010/11, for example the use of derivatives, wee will follow a similar approach to that noted above.

Risk area	Audit response
Lack of a separate bank account. During 2010/11 the pension fund has continued to use the County Council's bank account. This raises a potential risk of misallocation of money between the Pension Fund and the County Council. During the period actions have been taken in to prepare for the introduction of a separate bank account by April 2011. These include reducing the amount of cash going through the Council's bank account for pension fund investments. In addition a full reconciliation of the Pension Fund cash position will be available to support the opening of the new bank account.	We will: ■ review the actions taken to implement the new bank account; ■ test in detail the year end reconciliation of the pension fund cash held within the County Council's bank account as at 31/3/2010; and ■ consider the implications of this work on the cash balance recorded during the year and its use to calculate the interest due to or from the pension fund during the year.

Testing strategy

On the basis of risks identified above I will produce a testing strategy which will consist of testing key controls and substantive tests of transaction streams and material account balances at year end.

17 I can carry out the testing both before and after the draft financial statements have been produced (pre- and post-statement testing).

18 Wherever possible, I will complete some substantive testing earlier in the year before the financial statements are available for audit. I have identified the following areas where substantive testing could be carried out early:

- estimated future pension liabilities;
- reconciliation of Pension Fund year end cash invested in Lancashire County Council; and
- investments.

Where I identify other possible early testing, I will discuss it with officers.

19 Wherever possible, I will seek to rely on the work of Internal Audit to help meet my responsibilities. For 2010/11, I expect to be able to use the results of the following pieces of work:

- pensions payment system including the transfer of data from the old to the new pensions system;
- accounts payable;
- accounts receivable, and
- general ledger.

20 I will also seek to rely on the work of other auditors and experts, as appropriate, to meet my responsibilities. For 2010/11, I plan to rely on the work of other auditors for the accuracy and completeness of pensions contributions from admitted bodies.

21 I also plan to rely on the work of experts in relation to the actuarial estimates of future pension fund liabilities:

Audit Commission IAS 19 protocol

22 To avoid unnecessary duplication, the Audit Commission requires the auditors of local government pension funds to undertake a work programme as part of a protocol to provide opinion audit assurance on admitted bodies' LGPS pension fund assets and liabilities. Auditors are then required to report the outcome of this work to the auditors of the admitted bodies. This work relates to those assets and liabilities that arise as a result of applying International Accounting Standard 19 (IAS19). This assurance work includes:

- reviewing the actuary's analysis of the pension fund's assets to establish whether the asset value attributed to the admitted bodies' accounts are consistent with the total scheme assets considered in the audit of the pension fund's accounts, and
- making enquiries of the actuary in relation to their work in calculating IAS19 assets and liabilities.

Key milestones and deadlines

The Pension Fund is required to prepare the financial statements by 30 June 2011. I am required to complete the audit and issue the opinion by 30 September 2011.

23 The key stages in producing and auditing the financial statements are in Table 2.

24 I will agree with you a schedule of working papers required to support the entries in the financial statements. The agreed fee is dependent on the timely receipt of accurate working papers.

25 During the audit, the audit team will meet with the key contact and review the status of all queries. The frequency of meetings will depend on the need and the number of issues arising.

Table 2: **Proposed timetable**

Activity	Date
Control and early substantive testing	February-May 2011
Receipt of accounts	June 2011
Sending audit working papers to the auditor	June 2011
Start of detailed testing	July 2011
Progress meetings	As required
Present report to those charged with governance at the audit committee	September 2011
Issue opinion	By 30 September 2011

The audit team

Table 3 shows the key members of the audit team for the 2010/11 audit.

Table 3: **Audit team**

Name	Contact details	Responsibilities
Clive Portman District Auditor	c-portman@audit-commission.gov.uk 0844 798 7038	Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion, and liaison with the Treasurer
Fiona Blatcher Senior Audit Manager	f-blatcher@audit-commission.gov.uk 0844 798 7056	Manages and coordinates the different elements of the audit work. Key point of contact for the Head of Pension Fund and Senior Accountant.

Independence and objectivity

26 I have identified the following relationship that might affect objectivity and independence and have put appropriate safeguards in place.

Table 4: **Relationships and safeguards**

Relationship	Safeguard
A member of our audit team is related to a member of the pensions administration team.	Our member of staff does not undertake, or is responsible for the review of, any of our work which assesses the work of the pensions team.

27 I comply with the ethical standards issued by the APB and with the Commission's requirements in respect of independence and objectivity as summarised in Appendix 2.

Meetings

28 The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers. Our proposals are set out in Appendix 3.

Quality of service

29 I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director of Professional Practice, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ (c-westwood@audit-commission.gov.uk) who will look into any complaint promptly and to do what he can to resolve the position.

30 If you are still not satisfied you may of course take up the matter with the Audit Commission's Complaints Investigation Officer (The Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol BS34 8SR).

Planned outputs

31 My team will discuss and agree reports with the right officers before issuing them to the Audit Committee.

Table 5: **Planned outputs**

Planned output	Indicative date
Annual governance report	September 2011
Auditor's reports giving an opinion on the financial statements	30 September 2011
Final accounts memorandum [if needed]	November 2011

Appendix 1 Basis for fee

The Audit Commission is committed to targeting its work where it will have the greatest effect, based upon assessments of risk and performance. This means planning work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fees.

The risk assessment process starts with the identification of the significant financial and operational risks applying to the Pension Fund with reference to:

- my cumulative knowledge of the Pension Fund;
  - planning guidance issued by the Audit Commission;
  - the specific results of previous and ongoing audit work;
- interviews with Pension Fund officers; and
- liaison with Internal Audit.

Assumptions

In setting the fee, I have assumed that:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2009/10;
- you will inform me of significant developments impacting on the audit;
- Internal Audit meets the appropriate professional standards;
- [Internal Audit undertakes appropriate work on all systems that provide material figures in the financial statements sufficient that I can place reliance for the purposes of our audit];
- you provide:
  - good quality working papers and records to support the financial statements by [date];
  - information asked for within agreed timescales;
  - prompt responses to draft reports; and
- there is no allowance for extra work needed to address questions or objections raised by local government electors.

Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee.

Appendix 2 Independence and objectivity

Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors, which defines the terms of the appointment. When auditing the financial statements, auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).

The main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards are summarised below.

International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires that the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee that the auditor has charged the client; and
- confirms in writing that the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Audit Committee. The auditor reserves the right, however, to communicate directly with the Council on matters which are considered to be of sufficient importance.

The Commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure that they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.

The Standing Guidance for Auditors includes a number of specific rules. The key rules relevant to this audit appointment are as follows.

- Appointed auditors should not perform additional work for an audited body (ie work over and above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the Audit and Inspection Plan as being 'additional work' and charged for separately from the normal audit fee.
- Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.
- The District Auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional safeguards in the last two years.
- The District Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body.

The District Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

Appendix 3 Working together

Meetings

The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers.

My proposal for the meetings is as follows.

Table 6: **Proposed meetings with officers**

Council officers	Audit Commission staff	Timing	Purpose
Treasurer	District Auditor (DA) and Senior Audit Manager (SAM)	Monthly	General update plus: January - audit plan July - accounts progress September - annual governance report
Head of Pensions and Senior Accountant	Senior Audit Manager and Teamleader	Quarterly	Update on audit, accounting and governance issues
Internal Audit	DA and SAM	Tri-annually	Update on audit issues
Audit Committee and Pension Fund Committee	DA and SAM	As determined by the Committee	Formal reporting of: Audit Plan Annual governance report Other issues as appropriate

Sustainability

32 The Audit Commission is committed to promoting sustainability in our working practices and I will actively consider opportunities to reduce our impact on the environment. This will include:

- reducing paper flow by encouraging you to submit documentation and working papers electronically;
- use of video and telephone conferencing for meetings as appropriate; and
- reducing travel.

Appendix 4 Glossary

Audit of the accounts

The audit of the accounts of an audited body comprises all work carried out by auditors in accordance with the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

Audited body

A body to which the Audit Commission is responsible for appointing the external auditor, comprising both the members of the body and its management (the senior officers of the body). Those charged with governance are the members of the audited body. (See also ‘Members’ and ‘Those charged with governance’.)

Auditing Practices Board (APB)

The body responsible in the UK for issuing auditing standards, ethical standards and other guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

Auditing standards

Pronouncements of the APB, which contain basic principles and essential procedures with which auditors are required to comply, except where otherwise stated in the auditing standard concerned.

Auditor(s)

Auditors appointed by the Audit Commission.

Code (the)

The Code of Audit Practice.

Commission (the)

The Audit Commission for Local Authorities and the National Health Service in England.

Ethical Standards

Pronouncements of the APB that contain basic principles that apply to the conduct of audits and with which auditors are required to comply, except where otherwise stated in the standard concerned.

Financial statements

The annual statement of accounts or accounting statements that audited bodies are required to prepare, which summarise the accounts of the audited body, in accordance with regulations and proper practices in relation to accounts.

Internal control

The whole system of controls, financial and otherwise, that is established in order to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

Materiality (and significance)

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; likewise a misstatement is material if it would have a similar influence. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects’.

Those charged with governance

Those charged with governance are defined in auditing standards as ‘those persons entrusted with the supervision, control and direction of an entity’.

If you require a copy of this document in an alternative format or in a language other than English, please call:
0844 798 7070

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

Audit Commission

1st Floor
Millbank Tower
Millbank
London
SW1P 4HQ

Telephone: 0844 798 3131
Fax: 0844 798 2945
Textphone (minicom): 0844 798 2946

www.audit-commission.gov.uk January 2011

Pension Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected:
None

Internal Audit Plan 2011/12
(Appendix 'A' refers)

Contact for further information:
Ruth Lowry, (01772) 534894, or Rachel Tanner, (01772) 534904, County Treasurer's Department

Executive Summary

This paper sets out the plan of work to be undertaken by the County Council's internal audit service for the coming financial year in respect of the pension fund. The plan amounts to a total planned resource of **112 audit days**.

Recommendation

The Committee is requested to consider and approve the internal audit plan for 2011/12.

Background and Advice

The plan is intended to provide assurance to the Pension Fund Committee and to the chief executive and leader of the council who are jointly required to sign an annual governance statement (AGS), incorporating a statement on internal control. As the County Council is responsible for the administration of the pension fund, including the provision of systems, controls and governance, the AGS also embraces the activities of the pension fund.

Consultations

In deriving this plan the internal audit team has:

- Discussed with senior management the risks and related controls associated with the pension fund and

- Made its own assessment of the risks facing the pension fund.

The information derived from these consultations has been incorporated into the audit plan.

Implications:

This item has the following implications, as indicated:

Risk management

No significant risks have been identified

Financial

The cost of the audit service has been incorporated into the Authority's budget and is managed by the head of internal audit through the devolved financial management scheme.

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'

Lancashire County Pension Fund

Internal audit plan for the year 1 April 2011 to 31 March 2012

The Pension Fund Committee is invited to consider and approve this internal audit plan.

1. Executive summary

1.1. This paper sets out the plan of work to be undertaken by the internal audit service for the coming financial year. The plan amounts to a total resource of 112 audit days (2010/11: 120 days), and the Pension Fund Committee is asked to approve it, as providing the assurance it requires over the internal control of the pension fund.

2. Background

2.1. The plan is intended to provide assurance to the Pension Fund Committee and to the chief executive and leader of the council who are jointly required to sign an annual governance statement (AGS), incorporating a statement on internal control. As the county council is responsible for the administration of the pension fund, including the provision of systems, controls and governance, the AGS also embraces the activities of the pension fund.

2.2. The responsibility for maintaining and reviewing the system of internal control and for implementing a system of risk management clearly rests with management. However the process by which the AGS is made includes obtaining assurances on the effectiveness of key controls and internal audit provides one of the key sources of assurance.

2.3. The aim of this plan is to focus on an assessment of the risks to the achievement of the pension fund's objectives, and the provision of assurance that the actions planned and the controls implemented to mitigate these risks are adequate and effective. The Audit Service provides assurance that key controls are adequately designed and are operating effectively as intended.

3. Deployment of audit resources

3.1. The plan is stated in terms of estimated days input. However, neither the resources available, nor the exact time that will be taken for any single piece of audit work is capable of exact estimation at this stage. The plan therefore represents only best estimates of the audit resources and the ways in which they will be deployed.

3.2. The planned deployment of audit resources for the pension fund is as follows:

Proposed work	Estimated audit days
Pension fund	
New investment strategy	25
Governance arrangements	5
Global custodian	20
Procurement of new investment manager	15
New bank account	10
Investment manager assurance statements	5
Pension administration	
Pension administration – Altair system	25
Follow up	2
General management	5
Total audit days	**112**

3.3. The plan again focuses on two distinct areas which cover the governance and management of the pension fund's assets and pension administration. The audit reviews identified under each of these areas is explained in more detail below.

Pension fund

3.4. We have included audit resources to review the arrangements for investing funds under the revised investment strategy which was approved in December 2010. The revised strategy requires the fund to make a wider range of individual investment decisions, rather than simply placing funds with investment managers. This will involve implementing new procedures and processes which we will consider to assess the adequacy of the internal control arrangements.

3.5. We plan to undertake an overview of the governance arrangements currently operated for the pension fund which will include consideration of the current committee structure, and the liaison and reporting lines between members and senior officers in addition to the roles and responsibilities of key individuals associated with the pension fund.

3.6. We also propose to review the new arrangements which will be introduced during the coming year following the re-tendering of the global custodian services. It is intended that there will be a more direct link between the new global custodian's own systems and the council's Oracle Financials system and we plan to audit the security and integrity of data passing over this link. We also plan to review the ongoing oversight by the council over the new global custodian's activity.

3.7. As part of the pension fund's 2011/12 business plan it is the intention to review the current fund manager mandates, with a view to re-tendering a number of them. We will review the adequacy of the processes employed for the procurement of one of the new investment managers.

3.8. From April 2011 the pension fund will have its own bank account, separate from that of the county council, and we propose to review the controls introduced for this new arrangement.

3.9. Our work will continue to take maximum advantage of existing management assurance processes and reports, and follow an approach in line with guidance issued by the Society of County Treasurers and CIPFA. This will involve using statutory reporting from the investment managers and custodian in the first instance. These documents will be used to gain assurance over the external investment management activities where appropriate.

Pension administration

3.10. In the same way that we are required to consider controls over the county council's corporate financial systems, any assessment of the risks to the pension fund will require our assurance over the key controls over the administration of the fund. This year's work will be focussed on testing the key controls we documented as part of last year's review and the implementation of a new pensioner payroll system integrated within the pensions administration system.

Follow up reviews

3.11. Audit resources have been identified to ensure that all reviews are followed up and our findings are re-assessed as the actions previously agreed with management are implemented.

General management activities

3.12. An allocation of 5 days has also been made to cover other management and tasks in support of the internal audit service to the pension fund:

- Attendance at meetings;
- Liaison with the Audit Commission; and
- Central reporting.

Pension Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected: None

The Operation of the Investment Panel – Investment Decision Making

Contact for further information:
Mike Jensen, (01772) 534742, County Treasurer's Department,
mike.jensen@lancashire.gov.uk

Executive Summary

This report sets out proposals for the operation of the Investment Panel as a key element of delivering the new investment strategy, agreed by the Committee at its meeting on 10 December 2010.

It is vital to the successful implementation of the new investment strategy that the Investment Panel is rigorous, transparent and accountable to the Committee. The Investment Panel will in effect, be acting as the Fund's "internal investment managers" and as such, all decisions (whether it be a decision to proceed with or to withdraw from an investment opportunity) and supporting reasons must be transparent, and the Panel held to account by the Committee for performance.

The report also sets out the process that will be adopted by the Investment Panel in order to achieve clear transparency and accountability. This includes:

- the importance of due diligence
- the role of the independent advisors (specifically that agreement from both advisors is necessary for an investment proposal to proceed)
- the role of the Assistant Director of Finance as a check within the system
- the role of the Fund Treasurer
- accountability and reporting arrangements to the Pension Fund Committee
- the constitution, and
- the role of the Chair/Deputy Chair.

Recommendation

The Committee is asked to consider the proposed arrangements for the operation of the Investment Panel and in particular the role of the Chair and Deputy Chair.

Background and Advice

The Investment Strategy

At its meeting on 10 December 2010, the committee agreed a new investment strategy. The overall objectives of the strategy are:

Lancashire County Council

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

In order to achieve this, some significant changes to the investment strategy were agreed which are designed specifically to achieve the actuarial assumption of an annual return of gilts plus 2½%, taking into account the Fund's risk appetite.

The drivers for the change in investment strategy are:

- Deficit reduction leading to reduced and stable contribution rates
- Separate treatment and management of investment and liability risks, but with an overall reduction in the Fund's risk exposure
- Appropriate rewards for the risks the Fund is prepared to take
- Stability and improvement of performance, to reduce volatility and avoid large draw downs of the Fund's capital.

In order to deliver this, the Committee agreed a change in asset allocation designed to deliver long-term income streams to the fund, or to provide a counter balance against movements in equities.

As part of this change, the Committee agreed the revised role of the Investment Panel. The Panel will fulfil the role of internal "fund manager", controlling the distribution of cash (contributions, dividends, coupons etc) to asset classes as well as strategic and tactical allocation changes as driven by market circumstances and opportunity.

Whilst there will continue to be a number of traditional mandates managed by fund managers, over time, the Fund will move towards making one-off investments, for example, in unitised funds or specific projects.

It is important that with this change, the governance and accountability arrangements for the Investment Panel are clear. The Investment Panel is directly accountable to the Committee in terms of investment performance, and this is codified in the proposed constitution, set out elsewhere on the agenda. The Investment Panel will operate within the investment strategy agreed by the Committee, with the decisions taken (both in terms of investments approved and those not approved), and performance, reported to each meeting of the Committee.

As an important part of the accountability framework, the decision making process by the Investment Panel must be clear and transparent. In particular, it must be clear how differences in opinion between the independent advisors regarding a specific investment are resolved.

At the last meeting the Committee considered new governance arrangements for the Investment Panel, and raised specific concerns regarding accountability of the Investment Panel, and the process for resolving differences of opinion of Panel members. The Committee agreed that in order to provide greater accountability to the Committee that the Chair, or Deputy Chair, be a member of the Investment Panel.

This report sets out for the Committee:

- the process which the Investment Panel will follow
- the accountability and reporting arrangements to the Committee
- the position of the Chair/Deputy Chair.

The Investment Process

As set out above, the changes to the operation of the Investment Panel are part of the approval by the Committee of the Fund's new Investment Strategy in December 2010. This differs significantly from the previous strategy in a number of ways, specifically:

- The Fund will become more global in its investments;
- The Fund will be more actively managed than in the past;
- Asset allocations will be within broad ranges;
- There will be less manager concentration;
- Investments, subject to return criteria and risk analysis, will be in a wider range of asset types;
- The strategy will aim to have an impact on the Fund's liability exposure;
- The Strategy will include investments generating strong long term cash flows which will tend to be investments in funds rather than through managers.

A key component within the adoption of the strategy is that the Fund needs to have the capacity to, for want of a better phrase, "be its own investment manager". To achieve this effectively there needs to be an appropriate body to make, or recommend, investment decisions within the context of the strategy agreed by the Committee and for the decision making process to be much swifter than is traditionally the case in Funds which are wholly externally managed.

The appropriate body to formulate investment recommendations in the context of the Lancashire County Pension Fund is the Investment Panel. The Panel includes a minimum of two independent investment advisors appointed by the Committee, an internal investment professional, together with the County Treasurer and the Assistant Director of Finance. The Assistant Director of Finance has a specific role to act as a check within the system in terms of ensuring that risks to the fund are rigorously assessed and the Committee's strategy is strictly adhered to.

Given the constitutional framework within which local authorities operate the decision maker in these areas is the County Treasurer, as Treasurer to the Fund. In the discussion at the last meeting of the Committee members indicated a preference for greater member involvement in and direct oversight of the process.

The first principle is that all investment decisions must be made within the Investment Strategy agreed by the Committee. This strategy sets out both broad asset allocations and the expected returns from those allocations. This sets the basic framework within which the Investment Panel must operate. No investment proposal which falls outside the bounds of these criteria will be considered by the Panel. If the investment professionals on the Panel feel that there is reason to change elements of the strategy then they must make the case for this both to the Treasurer and to the Committee.

The first stage of the investment decision process is to identify an investment opportunity which merits further investigation. It is anticipated that this will be largely undertaken by officers within the Treasurer's Treasury Management and Pension Fund team, and in order to achieve this, the Leader of the Council approved the restructure of the team at his decision making session on 5 April 2011.

At this stage, an early indication is sought from the Independent Advisors, the Head of Treasury Management and Pension Fund and Assistant Director of Finance as to whether the further investigation should be undertaken at this stage. This stage indicates only that this is an opportunity worth looking at in the context of delivering the Investment Strategy.

The next stage of the process is best described as “due diligence” and involves officers compiling a detailed report on each opportunity covering:

- Fit within the specific asset class
- Compliance with the Investment Strategy criteria
- Risk and return characteristics of the investment
- Legal structure of the investment and constraints
- Price/duration and optionality characteristics.

As part of the internal compliance process, the reports will be signed off by the Assistant Director of Finance that appropriate due diligence has been undertaken. No opportunity will be considered by the Investment Panel without a completed, signed off, due diligence report.

This report will be considered by the three investment professionals on the Panel and unless there is unanimity among them then the opportunity will not be presented to a meeting of the full Panel chaired by the Treasurer for consideration.

Opportunities which do not achieve unanimous support at this stage will be reported to the full Panel for information together with the reasons for their rejection. If there are specific concerns that further investigation or modification may deal with the Panel may agree that further work be undertaken. This information will also be included in the Panel report to the Pension Fund Committee.

Opportunities that satisfactorily pass the “unanimity” test and the Panel debate are then laid before the Fund Treasurer for approval and implementation.

Reporting and Accountability to the Pension Committee

As the Investment Panel is acting as the Committee's "internal fund manager", it is vital that the Panel are held to account by the Committee, and that all decisions taken are clear and transparent.

After each Investment Panel meeting, a report will be presented to the Committee by the Treasurer which sets out:-

- The investment proposals presented for consideration
- The investment proposals rejected for consideration, and the reasons why
- The "business case" for each investment presented for consideration. This will including the anticipated return and the specific performance measures to be adopted for each individual investments which will monitor the effectiveness of the decision and the efficiency of the implementation
- The investment proposals accepted or rejected and the reasons for the decision.

This enables the Committee to hold the Treasurer accountable for the investment decisions taken, as the accountable officer charged under the scheme of delegation with delivering the Committee's investment strategy. It must be stressed that the Treasurer cannot allocate any funds for approval without the prior agreement of the two independent advisors and the internal investment professional. This is codified within the proposed constitution of the Pension Fund Committee, set out elsewhere on the agenda.

At the last Committee meeting, members agreed that either the Chair or Deputy Chair would sit as a member of the Investment Panel. This proposal has been carefully considered by officers and the Committee is advised that membership of the Panel would place the Chair and Deputy Chair in a difficult position as having been seen to be party to the original decisions they would not then be able to participate in the Committee's consideration of the Investment Panel report. It is therefore recommended that the Committee re-consider its original view.

Consultations

The two independent advisors have been fully consulted on the development of new methods of operation of the Investment Panel, and support the proposals within the report.

Implications:

This item has the following implications, as indicated:

Risk management

The Investment Panel is charged with monitoring the performance and risk management of the Fund at an overall level, whilst monitoring the activities of the individual external fund managers and internal investments on a regular basis.

Local Government (Access to Information) Act 1985

Paper	Date	Contact/Directorate/Tel
N/A		

Reason for inclusion in Part II, if appropriate

N/A

Pension Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected:
None

Revised Governance Arrangements
(Appendix 'A' refers)

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

Executive Summary

This report proposes a revised "constitution" for the Pension Fund Committee, which reflects the impact of the new Investment and Liability Strategy on the Fund's decision making and governance.

Recommendation

The Committee is asked to consider the revised "constitution" for the Pension Fund Committee as set out at Appendix 'A' and recommend the "constitution" to the Full Council for approval.

Background and Advice

The Committee at its meeting on 10 December 2010 approved a new investment strategy for the Fund. The new strategy has implications for the Fund's decision making and governance arrangements and the Committee at its meeting on 4 February 2011 requested the County Secretary and Solicitor to draft a new "constitution" to reflect new ways of working required by the Strategy.

In considering the report, the Committee was informed that the Fund's governance arrangements needed to reflect a number of key drivers set out in the investment strategy.

- Firstly, the Fund must be managed more dynamically so it is able to take advantage of opportunity and move to avoid risk. To this end decision making arrangements must, subject to appropriate checks and balances, be capable of operating swiftly.
- Secondly, the role of the Committee is to approve strategy and hold the Investment Panel to account for its delivery, particularly as the Investment Panel will be acting as an "internal investment manager" on behalf of the Committee.

Lancashire County Council

A report on the future operation of the Investment Panel as the Fund's "internal investment manager" is set out elsewhere on the agenda. That report sets out the proposed investment decision making arrangements including the investment process and reporting and accountability to the Pension Fund Committee. The Pension Fund Committee's governance documents as set out at Appendix 'A' have been amended to reflect the changes to the operation of the Investment Panel.

The Committee will note that the governance documents have also been amended to provide greater transparency and accountability, particularly around the management of the Fund's property portfolio, reporting arrangements and the process of preparing and approving pension fund policies, statements, strategies and procedures. In February 2011 the Committee agreed to disestablish the Pension Fund Appointments Sub-Committee and to implement a new procurement process that would be more aligned to EU procurement rules. These changes have also been made to the Pension Fund Committee's governance documents.

The Full Council is required to approve the Council's Constitution and any subsequent amendments including changes to a committee's terms of reference. The Committee is therefore asked to consider the revised governance documents as set out at Appendix 'A' and recommend the amended "constitution" to the Full Council for approval.

Consultations

N/A

Implications:

This item has the following implications, as indicated:

Risk management

The Pension Fund Committee's governance documents need to be updated to reflect the new ways of working required by the new Investment Strategy.

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

Appendix 'A'

Pension Fund Committee

Composition and role

1. The Pension Fund Committee ("the Committee") comprises fourteen County Councillors and seven voting co-optees representing the following organisations:

    a. One co-optee representing the Further and Higher Education sector in Lancashire;
    b. One co-optee from Blackburn with Darwen Council;
    c. One co-optee from Blackpool Council;
    d. Two co-optees representing Trade Unions; and
    e. Two co-optees representing the Lancashire borough and city councils.

2. The role of the Committee is to:

    a. exercise responsibility for the administration of the Lancashire County Pension Fund ("the Fund");
    b. establish policies in relation to investment management, which shall include meeting with the Investment Panel to consider future investment policy for the Fund;
    c. monitor and review investment activity and the performance of the Fund; and
    d. present an annual report to the Full Council on the state of the Fund and on the investment activities during the preceding year.

3. Meetings of the Committee shall be open to the public, but the public may be excluded where information of an exempt or confidential nature is being discussed – see Access to Information Procedure Rules set out at Appendix 'H' to the County Council's Constitution.

Terms of Reference

1. To exercise Lancashire County Council's responsibility for the management of the Fund, including the administration of benefits and strategic management of Fund assets and liabilities.

2. To have overall responsibility for investment policy and monitor overall performance.

3. To submit an annual report to the Full Council on the performance and state of the Fund and on the investment activities during the year.

4. To appoint a minimum of two suitable persons to an Investment Panel through a sub committee convened for that purpose.

5. To meet at least quarterly, or otherwise as necessary, with the Investment Panel in attendance.

6. To review governance arrangements and the efficient and effective use of external advisors to ensure good decision-making.

7. To approve the policies and procedures for any internally managed Fund investments.

8. To establish a Pension Fund Administration Sub-Committee and agree its composition, role and terms of reference.

9. To receive regular reports from the Treasurer to the Fund on the administration of the Fund to ensure that best practice standards are satisfied and met and to satisfy itself that and justify to all stakeholders, including Fund Employers, that the Fund is being run on an efficient and effective basis.

10. To approve the procurement process, tender award criteria and evaluation methodology in advance of any tender being invited for the appointment of external advisers and other external assistance in relation to the management of the Fund, to include:

    a. external Investment Managers to discharge functions to be determined by the Committee relating to the management of the Fund's investments;
    b. external property agents and advisors;
    c. an external corporate governance adviser;
    d. an external Fund custodian;
    e. external performance measurement advisers;
    f. the Fund Actuary; and
    g. the Fund's AVC Provider.

11. To approve an Annual Business Plan, Statement of Investment Principles, Governance Policy Statement , Treasury Management Strategy and Policy and Governance Compliance Statement.

12. To approve the Pension Fund Annual Report.

13. To approve a Funding Strategy statement to include the Fund's policy in respect of:

    a. the Funding Target;
    b. the collection of employee contributions;
    c. the collection of employer contributions;
    d. the collection of additional employer contributions; and
    e. Admissions and Terminations.

14. To determine which pension related functions and responsibilities should be exercised under the Council's Scheme of Delegation to Chief Officers.

15. To approve the overall appropriate and necessary training requirements for members of the Committee.

Pension Fund Administration Sub-Committee

Composition and role

1. The role of the Pension Fund Administration Sub-Committee ("the Sub-Committee") is to ensure that best practice standards are satisfied and met and to satisfy itself that and justify to all stakeholders, including Fund Employers, that the Fund is being run on an efficient and effective basis.

2. The Sub-Committee shall meet at least twice a year or otherwise as necessary.

3. The membership of the Sub-Committee shall be determined by the Pension Fund Committee ("the Committee"). The current membership is five County Councillors, one Trade Union representative and one representative from either the Lancashire borough and city councils or the Lancashire Unitary Authorities. All members have voting rights.

Terms of Reference

1. To ensure that the Committee's functions as Administering Authority are discharged and approve an Annual Administration Report.

2. To agree the terms of a Service Level Agreement in relation to the provision of administration services and support.

3. To submit reports and make recommendations to the Committee relating to the administration of the Lancashire County Pension Fund.

4. To respond to any Government consultations relating to the administration and benefits of the Local Government Pension Scheme.

5. To approve the following:

   a. Pensions Administration strategy statement;
   b. Communication Policy statement;
   c. Internal Dispute Resolution procedure;
   d. Death Grant procedure;
   e. Bulk Transfer Payment policy;
   f. Commutation policy (small pensions);
   g. Transfer policy; and
   h. Abatement policy.

Investment Panel

Composition and role

1. The Investment Panel ("the Panel") will provide expert professional advice to the Pension Fund Committee in relation to investment activities, including the following categories of investment:

   a. fixed interest securities managed by Investment Managers;
   b. UK equities managed by the Investment Managers;
   c. overseas equities and bonds managed by Investment Managers;
   d. local investment in the acquisition and development of property in accordance with the investment strategy approved by the Pension Fund Committee;
   e. UK and overseas unquoted investments via venture capital funds and other local arrangements;
   f. acquisition of land and premises and the development of such land and improvements, refurbishment and modernisation of such premises;
   g. indirect pooled property investments;
   h. designated index linked funds;
   i. investments managed internally and not by Investment Managers; and
   j. any other monies to be invested other than in the above categories;

   provided that in all cases the investment activity is consistent with the investment strategy approved by the Pension Fund Committee.

2. The Panel will:

   a. review the Fund's long term investment strategy and where necessary make recommendations to the Pension Fund Committee;
   b. monitor the performance of the Fund's Investment Managers; and
   c. report on the performance of the Fund and where necessary make recommendations to the Pension Fund Committee.

3. The Panel does not exercise any delegated powers but instead will provide advice to the Treasurer to the Fund who will either exercise his/her delegated powers or make recommendations to the Pension Fund Committee taking into account the advice and views from the Panel.

4. The membership of the Panel comprises:

   a. The Treasurer to the Fund (as Chair);
   b. Not less than two independent advisers appointed in accordance with arrangements determined by the Pension Fund Committee;
   c. The officer of the County Council fulfilling the role of Chief Investment Officer for the Fund; and
   d. An officer of the County Council identified by the Treasurer to the Fund to oversee investment activities.

5. The Panel will meet at least quarterly, or otherwise as necessary.

6. The Panel may operate through sub groups to undertake particular tasks, but will formulate recommendations to the Treasurer to the Fund and or the Pensions Fund Committee through meetings of the full Panel.

Terms of Reference

1. 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 performance management of Investment Managers;
   c. The broad composition of the Fund's investment portfolio, management style and types of investment;
   d. 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;
   e. The selection and appointment of any required external support (subject to the role of the Pension Fund Committee), their terms of office and remit;
   f. The allocation of ranges and thresholds within which the Investment Managers should operate;
   g. Review of the Statement of Investment Principles and compliance with investment arrangements;
   h. Recommendations on the detailed management of the investment portfolios to respond to requests from investment managers to vary certain aspects of their mandates;
   i. The performance management of an internally managed investments; and
   j. The securing of specialist advice within allocated budgets.

Scheme of Delegation to Chief Officers

Council and Committee Functions

County Treasurer

Pensions Fund

As Treasurer of the Lancashire County Pension Fund:

1. Subject to the prior agreement of the two independent advisers on the Investment Panel to allocate monies for investment in the following categories of investment:

   a. categories fixed interest securities managed by Investment Managers;
   b. UK equities managed by Investment Managers;
   c. overseas equities and bonds managed by Investment Managers;
   d. local investment in the acquisition and development of property in accordance with the investment strategy approved by the Pension Fund Committee;
   e. UK and overseas unquoted investments via venture capital funds and other local arrangements;
   f. acquisition of land and premises and the development of such land and improvements, refurbishment and modernisation of such premises;
   g. indirect pooled property investments;
   h. designated index linked funds;
   i. investments not to be managed by Investment Managers; and
   j. other monies to be invested other than the above categories.

   provided that in all cases the investment activity is consistent with the investment strategy approved by the Pension Fund Committee.

2. To report to each meeting of the Pension Fund Committee:

   a. the investments authorised by the Treasurer to the Fund in accordance with paragraph 1 above since the previous meeting of the Pension Fund Committee, including the recommendations made by the Investment Panel in relation to each investment ;and
   b. any investments that were considered by the Investment Panel but were not actioned by the Treasurer to the Fund together with the reasons for this.

3. To set the appropriate funding target for the Fund.

4. To place any monies not allocated to investments on short term deposit in accordance with the Treasury Management Strategy and Policy approved by the Pension Fund Committee.

5. In consultation with the Investment Panel, to monitor and review the performance of investments made by Investment Managers and to report to each meeting of the Pension Fund Committee on the exercise of this delegation.

6. To be responsible for the management of the Fund's property portfolio in accordance with the policy guidelines of the Pension Fund Committee and subject to the Procurement rules and Financial Regulations of the County Council, comprising:-

   a. the negotiation and acceptance of terms for the acquisition, development and redevelopment and disposal of land and buildings;

b. the acquisition and disposal of incidental property vehicles;

c. the negotiation and acceptance of terms for the granting, renewing, reviewing, varying or assignment of leases, underleases, tenancies, licences and any other interest in Fund property;

d. the preparation and implementation of schemes of works of modernisation, improvement, maintenance and repair to Fund property together with the invitation and acceptance of tenders and the authorisation of expenditure on such works;

e. the appointment and supervision of managing agents and professional advisors necessary for the effective management of the Fund's property portfolio, within budget provision;

f. the collection of all rents, the setting of management and collection of service charges, insurance premiums and any other monies arising out of the Fund's property portfolio, together with the approval of any in-house systems established to achieve this; and

g. The placing of insurance cover for the Fund's property portfolio to such value and for such risks as shall be considered appropriate.

7. To execute documentation relating to the implementation of a new investment mandate or existing investment mandates, including the renewal of property leases.

8. To maintain all necessary accounts and records in relation to the Fund save as otherwise discharged in accordance with arrangements determined by the Pension Fund Administration Sub-Committee.

9. To arrange and authorise the provision of appropriate training for members of the Pension Fund Committee including the attendance at conferences and other similar pension fund related events by members of the Pension Fund Committee.

10. To accept for admission into the Lancashire County Pension Fund employees of authorities and bodies as prescribed in Regulations including transferee and community admissions which are considered as 'exceptional circumstances', subject to an approved Admission Agreement, and subject to any necessary indemnities as appropriate.

11. To prepare and submit the following to Pension Fund Administration Sub-Committee:

a. Pension Administration Strategy statement;
b. Commutation policy (small pensions);
c. Internal Dispute Resolution procedure;
d. Death Grant procedure;
e. Bulk Transfer Payment policy;

f. Transfer policy;
g. Abatement policy; and
h. Communication policy statement;

and to arrange for the implementation and review as necessary of the above-mentioned statements, strategies, policies and procedures

12. To prepare and submit the following to the Pension Fund Committee:

a. Pension Fund Annual Report;
b. Annual Business Plan;
c. Statement of Investment Principles;
d. Funding Strategy statement including the Fund's policy in respect of:

(i) the Funding Target;
(ii) the collection of employee contributions;
(iii) the collection of employer contributions;
(iv) the collection of additional employer contributions;
(v) Admissions and Terminations;

e. Governance Policy Statement;
f. Governance Compliance Statement; and
g. Treasury Management Strategy and Policy

and to arrange for the implementation and review as necessary of the above-mentioned statements, strategies, policies and procedures.

13. To carry out the administrative functions of the administering authority relating to the Local Government Pension Scheme, under the terms of a Service Level Agreement.

14. The payment of death grants in accordance with the agreed Death Grant Procedures.

15. To deal with stage 2 appeals under the Internal Dispute Resolution Procedure.

16. To arrange and authorise appropriate and necessary training for members of the Committee.

Pension Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected:
None

Pension Fund Treasury Management Policy and Strategy 2011/12

Contact for further information:
Mike Jensen, (01772) 534742, County Treasurer's Department

Executive Summary

From 1 April 2011, the Pension Fund will be keeping its money in its own bank account separate from that of the County Council. With keeping its money separate, it is best practice for the Pension Fund to have its own Treasury Management and Investment Strategy, recognising the unique features of the Fund.

This report presents the proposed Pension Fund Treasury Management Policy and Strategy for 2011/2012, including the cash management strategy.

While the routine cash balances of the Pension Fund are relatively small, the Pension Fund may have very substantial balances to invest from time to time or may need to borrow on a short term basis, for example, when investment transitions between mandates are taking place.

Recommendation

The Committee is asked to approve the Pension Fund Treasury Management Policy and Strategy for 2011/12.

Background and Advice

The Pension Fund has in the past conducted its treasury management activities within the general policy and strategy approved by Lancashire County Council and the stipulations laid down in CIPFA's Prudential Code for Capital Finance and Treasury Management Code of Practice.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 require the Pension Fund to have its own bank account separate from that of the administering authority from 1 April 2011. With its own funds and substantial cash balances from time to time, it is best practice for the Pension Fund to develop its own Treasury Management Policy and Strategy tailored to its specific needs.

Lancashire County Council

1. Pension Fund Treasury Management Policy and Strategy 2011/12

In setting the Treasury Management Strategy, economic forecasts and the forecast level of the cash balances have been taken into account. It covers the following aspects of the treasury management function:

- prudential indicators which provide a controlling framework for the treasury management activities of the Fund
- prospects for interest rates;
- the borrowing strategy;
- the investment strategy; and
- the risk profile.

The following Treasury Management statements and reports will be considered by the Pension Committee and Investment Panel as follows:

Treasury Management	Committee	Frequency
Policy Statement	Pension Committee	Initial adoption in 2011, updated thereafter as needed
Annual Investment Strategy	Pension Committee	Annually before the start of the each financial year
Annual Investment Report	Pension Committee	Mid year
Treasury Management Monitoring Reports	Investment Panel	Quarterly
Scrutiny of treasury management strategy	Investment Panel	Annually
Scrutiny of treasury management performance	Investment Panel	Quarterly

2. Prudential Indicators for 2011/12 to 2013/14 in respect of the Pension Fund's Treasury Management Activities

In accordance with its statutory duty and with the requirements of the Prudential Code for Capital Finance and the CIPFA Code for Treasury Management, the Fund will produce each year a set of prudential indicators which regulate and control its treasury management activities.

The following table sets out the debt and investment-related indicators which provide the framework for the Fund’s borrowing and lending activities over the coming three years:

Pension Fund Treasury Management Prudential Indicators		**2011/12 £M**	**2012/13 £M**	**2013/14 £M**
(i)	**Authorised limit for external debt**			
	A prudent estimate of external debt, which reflects the Fund's potential short term cash-flow needs and allows sufficient headroom for unusual cash movements.			
	Borrowing	200	200	200
(ii)	**Operational boundary for external debt**			
	A prudent estimate of debt, without allowance for extraordinary events.			
	Borrowing	100	100	100
(iii)	**Upper limit for fixed rate debt**			
	This limit reflects the fact that the Fund may wish to have most of its borrowing at fixed rates.	100%	100%	100%
(iv)	**Upper limit for variable rate debt**			
	This limit reflects the potential need to take some variable rate debt if interest rates rise to a point where fixed rate borrowing is not attractive.	50%	50%	50%
(v)	**Limit for Investments over 364 Days**			
	This limit applies for bank deposits and corporate bonds only and does not apply to investments in UK or AAA rated foreign Government or Supra-national Bank Securities.	75%	75%	75%

3. Borrowing Strategy

The Fund has no plans to borrow money, but under the Fund's regulatory regime, it may do so in certain limited circumstances, namely to:

(a) pay benefits due under the scheme; or

(b) meet investment commitments arising from the implementation of a decision by it to change the balance between different types of investment

The Fund may only borrow money if, at the time of borrowing, the Treasurer to the Fund reasonably believes that the sum borrowed and interest charged in respect of such sum can be repaid out of the Fund within 90 days of the date of the borrowing.

If borrowing were necessary, the Treasurer, with the Treasury Management Team, would seek the most cost effective and prudent source of funds appropriate for the purpose. Borrowings would be structured in such a way as to be most suitable for the specific need.

4. Cash Management and Investment Strategy

The Fund will have regard to the Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The Fund's Cash investment priorities are:

(a) the security of capital;
(b) the liquidity of its investments; and
(c) investment returns

The Fund will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity and the overall objectives of the Investment Strategy.

Under the Pension Fund's previous investment strategy (prior to the 2010 actuarial valuation) the amount of cash held by the Fund with the County Council was limited to monthly cash flow from contributions which was then used to aid regular rebalancing of the Fund and for cash calls from external managers.

The revised investment policy adopted by the Pension Fund Committee in December 2010 will involve the Fund in a number of asset class and manager transitions and the strategic allocation of investment income. These events will involve the Fund holding higher cash balances for short periods than in the recent past. It will be necessary to manage these flows efficiently allowing the fund suitable liquidity, security and returns, commensurate with the overall investment objectives of the Fund. Due to the nature of the Fund's overall global investment strategy, cash may be denominated in a number of currencies, predominately Sterling, US Dollars, and Euros. It is envisaged that the Fund's custodian will deal with most non-sterling cash, and certainly all currencies not listed above.

The proposed investment matrix is outlined below. It is important to note that the changes in strategic investment policy may generate large temporary cash balances during transitions and other events.

Instrument	Credit Rating (using Sector criteria)	Maximum Individual Investment (£m)	Maximum Maturity (not investment period)
Government Bonds and Treasury Bills	AA+	1,000	50 yrs
Supranational Bonds G10 Sovereign Bonds	AA+	1,000	50 yrs
Investment Grade Corporate Bonds	AAA AA A	250 150 75	25ys 10yrs 5yrs
General collateral reverse repurchase agreements	AA+ or better	1000	1yr
Term Deposits with UK and Overseas Banks (domiciled in UK) and Building Societies	Purple (Highest quality, greatest certainty of support) Orange (Highest quality, slightly less certainty of support) Red (Highest quality but lower than orange) Green (Quality, but lower than Red and lower certainty of support)	200 100 50 25	1 yr 1yr 3 months 1 months
Public Works Loan Board – Debt Management Office Deposit Facility	Government Institution	500	Less than 6mths
Other UK Local Authorities and Pension Funds	AAA (implied currently)	500	50yrs

Instrument	Credit Rating (using Sector criteria)	Maximum Individual Investment (£m)	Maximum Maturity (not investment period)
Money Market Funds	AAA Rated, weighted average maturity 6 months	250	These investments do not have a defined maturity date.
Bond Funds	AAA Rated Weighted average maturity less than 5yrs	200	These investments do not have a defined maturity date.
Certificates of Deposit. Collateralised lending agreements backed by higher quality government or local government and supra national securities.	AA, with AAA for any collateral used	500	5yrs
Non credit rated "nationalised" banks	Blue	250	1yr

The placing of residual overnight deposits will be with either the Fund's custodian or the County Fund.

There is currently still a high degree of turbulence in the financial markets and this matrix would enable the Fund to hold a high proportion of investments with banks holding explicit Government guarantees, support or ownership, or in bonds of similar credit quality.

Money market and Bond funds provide similar security and liquidity opportunities to call accounts. The AAA rated funds that the Fund would look to invest in hold Government securities and high quality corporate bonds as their main assets.

5. Day to Day Investment Management

The total cash investments managed will be variable and dependant on the general investment activity of the Fund. In circumstances where investments are in transition, cash balances can be high when investments have been sold with one manager and purchase by another manager is pending. In such cases, exposure to the relevant investment markets is maintained by the use of derivatives contracts.

With derivatives contracts, the Fund retains the use of the principal amount (less any margin paid). It must pay over interest at Libor (London inter-bank overnight rate) in return for the defined return (e.g. that based on a share index). The Treasurer and the Treasury Management Team will carefully manage the investment of the principal with the objective of out-performing Libor but without taking any additional risk to the Fund over its normal cash investment strategy. The margin achieved over Libor is additional return to the Fund over and above the index-based return of the derivative.

With base rates at exceptionally low levels, cash investment returns are likely to continue to be far lower than has been the case in recent years.

It is anticipated that Fund's cash balances will continue to be managed 'in-house', but if circumstances were appropriate, the Fund may consider the appointment of external providers of treasury management services. The Treasurer and the Treasury Management Team will continually monitor the attractiveness of external funds and report to the Committee if there is any potential value in utilising external investment managers.

In recent times, a wider range of investment instruments within the area of cash deposits has been developed by financial institutions. All of these afford similar security of capital to the basic sterling deposits currently in use, but they also offer the possibility, although never of course the certainty, of increased returns. The Treasurer and the Treasury Management Team will, in liaison with the Fund’s advisers, consider the benefits and drawbacks of these instruments and whether any of them are appropriate for the Fund. The Bloomberg financial system used by the Treasury Management Team allows for detailed analysis and value calculation of such deposits.

6. Investment with the County Fund

While the Fund must maintain a bank account separate from that of the County Council, it may co-mingle its funds in order to invest jointly with the County Council in the County Fund (the County Council's book of cash deposits and bonds), provided that proper tracking and reconciliations are undertaken.

Consultations

The Fund's Independent Advisers have been consulted on this preparation of this strategy

Implications:

This item has the following implications, as indicated:

Risk management

This is covered throughout the report.

Legal

The Treasury Management activities must be in accordance with the "Prudential Code for Treasury Management in Local Authorities".

Financial

The objective of the revised Treasury Management strategy is to improve investment returns while reducing the financial risks to which the Fund is exposed.

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

Paper	Date	Contact/Directorate/Ext
Sector - Recommended Lending Criteria	2010/11	Andy Ormerod – County Treasurer's Department Ext 34740
CIPFA Treasury Management Code of Practice	2009	Andy Ormerod – County Treasurer's Department Ext 34740

Reason for inclusion in Part II, if appropriate

N/A

Pension Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected: None

Appointment of Consultancy Bench

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

Executive Summary

The Pension Fund Committee approved the tendering for a bench of specialist investment consultants at its meeting on 26 March 2010. A full procurement process was run in consultation with the County Council's Procurement Team.

The respondents to the tender all passed the Pension Fund's pre-qualifying criteria and it is proposed that a Specialist Consultancy Bench with three sections; Asset Allocation, Investment Manager Selection and Liability Asset Management be set up with six to eight members on each section.

When the Fund needs the services of an investment consultant, the Fund will run a mini-competition amongst the members of the relevant section to obtain the best advice, ideas and price, rather than relying on the services of a generalist consultant. The Bench is also constructed in such a manner as to encourage members of the Bench to contribute pro-actively original ideas, which the Fund can then develop for its benefit.

Recommendation

The Committee is asked to approve the appointment of the Specialist Consultancy Bench as set out in the report.

Background and Advice

The Pension Fund has used the services of a general investment consultant for many years. It was decided to set up a bench of specialist investment consultants to enable the Pension Fund to access a range of specialist consultants and to encourage the appointed consultants to be more pro-active in developing new ideas, which would benefit the Fund. It is proposed that the consultancy bench comprises three sections or lots, namely Asset Allocation Strategy, Investment Manager Selection and Liability Asset Management.

Lancashire County Council

The procurement process was run by the County Council's Procurement Team and Pension Fund staff with the help of an experienced pension fund consultant, who was appointed to help draft appropriate questions for the tender documentation.

Eleven consultancy firms responded to the invitation to tender. The respondent firms all passed the Pension Fund's pre-qualifying criteria. The firms, which responded, were of a range of different sizes and specialisms and as such it is proposed that all be accepted on to the Consultancy Framework. This produces three sections to the Consultancy bench, each with six to eight members as follows:

Firm	**Asset Allocation**	**Manager Selection**	**Liability Asset Management**
Pensions First Limited	X		X
Redington Limited	X		X
Allenbridge Group plc	X	X	X
AEGON Asset Management	X		
Bfinance UK Limited		X	
Hymans Robertson LLP	X	X	X
Mercer Limited	X	X	X
Institutional Investment Advisors Limited		X	
Russell Investments Limited.	X	X	
Xafinity Consulting Limited			X
Cardano Risk Management	X		X

This will provide access to a broader range of specialist expertise to support the Investment Panel and as such the Committee are recommended to approve the setting up of the Consultancy Bench.

Consultations

Alan Course (external consultant) and the County Council's Procurement Team.

Implications:

This item has the following implications, as indicated:

Risk management

The specialist consultancy bench will provide the Investment Panel with access to a greater level of specialist advice, which at the same time; will promote the development of new ideas for the Fund. This will strengthen the advice available to the Fund, and is an important element of the strategy for managing the Fund's assets and liabilities to minimise risk whilst maximising both securing of capital and return.

Financial

The specialist consultants will enable the Investment Panel to manage the Pension Fund assets and liabilities more effectively.

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

Pension Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected:
None

Report of the Independent Public Service Pensions Commission
(Appendix 'A' refers)

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

Executive Summary

The final report of the Independent Public Service Pensions Commission chaired by Lord Hutton was published on 10 March 2011. The report recommends significant changes to the Local Government Pension Scheme while maintaining the scheme as the only major public service scheme that is funded. Details of the recommendations are set out at Appendix 'A'.

There is significant detail of the proposed changes which remain to be negotiated and at this stage implementation of the changes, which will also require primary legislation, seems unlikely to be before 2015.

Recommendation

The Committee is asked to note the proposals of the Independent Public Service Pensions Commission.

Background and Advice

Appendix 'A' presents a summary of the proposals contained in the report of the Independent Public Sector pensions Commission. The Chancellor of the Exchequer has indicated in his budget statement the Government's acceptance of the Commission's recommendations.

Consultations

N/A

Implications:

This item has the following implications, as indicated:

Change on the scale envisaged by the Commission has significant implications both for the Fund and for individual employers. However, these will not become clear until the detailed implementation process fills in details in key areas of the proposal.

However, the broad objective of the report is to seek to make schemes more affordable to the taxpayer. In the context of the Lancashire County Council Pension Fund this would be evidenced through a number of means including a long term reduction in liabilities, or a reduction in employer contribution rates.

Risk management

N/A

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

Paper	Date	Contact/Directorate/Tel
Report of the Independent Public Sector Pensions Commission available at: http://www.hm-treasury.gov.uk/indreview_johnhutton_pensions.htm		

Reason for inclusion in Part II, if appropriate

N/A

Appendix 'A'

Report of the Independent Public Service Pensions Commission

Introduction

The final report of the Independent Public Sector Pensions Commission chaired by the former Labour Cabinet Minister Lord (John) Hutton was published on 10th March 2011. The Commission was established by the Chancellor of the Exchequer to examine the nature of reforms to the whole public sector pensions system to place it on a sustainable basis.

While the Local Government Pension Scheme (LGPS), of which the Lancashire County Pension Fund is part, forms part of the overall public sector pensions landscape it is significantly different to the bulk of schemes in that it is a funded scheme. All the same the Commission's conclusions are as applicable to LGPS as to other schemes.

The Commission proposes a new pensions "deal" for the public sector supported by a range of automatic stabilising mechanisms intended to share risk on an appropriate basis between scheme beneficiaries and employers and tax payers.

This "deal" is set within a context built on two important pillars:-

- Firstly, pensioner saving is a "good thing" which should be encouraged, not least because it has the potential to reduce the potential calls on other areas of public expenditure such as the benefits system.
- Secondly, it is not appropriate to engage in a "chase to the bottom" in terms of the quality of pension provision in the public sector.

The Commission has designed its proposals around four principles; that any new scheme should be:

- affordable and sustainable;
- adequate and fair;
- support productivity; and
- transparent and simple.

The Deal

The table below summarises what the report describes as the deal between public service workers and taxpayers:

Public service workers	Taxpayers
•A good pension in retirement: A level of pension that at least meets agreed adequate standards of Pension - taken together with full state pension this should deliver on average more than two thirds of pre-retirement salary for those below median income.	**•Fairer sharing of the benefits of living longer:** Public service workers will over time be expected to work longer - most to state pension age - before they take their pension. This will rebalance the proportion of adult life spent in retirement.
•A defined benefit pension: A pension based on average salary indexed by average earnings over a member's career. This should benefit the majority of members who do not have the high salary growth rewarded in a final salary scheme.	**•Future-proofed:** Pension age in most public service schemes will be expected to keep in line with changes to life expectancy through a link to state pension age changes.
•Accrued rights protected: The years a member has already worked will provide a pension at the current pension age linked to a members final salary. This will protect existing staff from the full impact of a change from a final salary scheme to a career average in proportion to their age and career length.	**•Fixed cost:** The Government should establish a fixed cost for the employers' contribution to public service pension schemes. If cost grows beyond this level then action will be taken to get back to this level.
•Fair process of change: The details of change should be the subject of consultation with staff and unions.	**•Greater transparency of cost:** Figures for the current and future expected cost of public service pensions should be published more regularly, consistently and transparently.
•Better management of schemes: Improved standards of governance and administration with staff Involvement through member representation.	**•Single legal framework:** Public service pensions should have a new legal framework with consistent approach to control and governance.

The "deal" is intended to provide considerably greater clarity for scheme beneficiaries, employers and taxpayers on what they can expect of the public service pension system.

Importantly the element covering "a good pension in retirement" also acts to promote pension saving through setting an objective that a combination of earned pensions and state pension should provide an income which avoids the need to access means tested benefits in retirement. This should provide a significant positive marketing point to encourage scheme membership.

Scheme Design

While the Commission favours the retention of a defined benefits structure it does make recommendations for a fundamental change in the way in which that benefit is calculated.

What is proposed is a career average revalued earnings (CARE) scheme. This means that benefits will be calculated based on average earnings over the period of scheme membership adjusted in line with average earnings.

This form of scheme design will make little difference to the benefits payable to a large proportion of scheme members who see their pay vary within a relatively narrow band over their career. It will, however, impact on so called "high flyers" who see significant increases in salary over a career. For these members the scheme will still represent good value relative to alternatives and the Commission takes the view that higher earners are more able to make additional provision from retained income.

The Commission argues for a single basic scheme design across the public sector with a normal retirement age set at 65 (60 for the uniformed services) rising in line with the state pension age. The normal retirement age in LGPS is already 65 so this represents no change. However, the Commission also states that scheme members should have greater choice over when to take benefits, subject to actuarial adjustment. It also proposes measures to increase the attractiveness of flexible retirement. This latter has in the past attracted some criticism, viewed as "double dipping", but is viewed positively by the Commission in the context of workforce planning and the ability for scheme members to ensure adequate incomes into eventual full retirement.

One key feature is the proposal that there should be a fixed cost ceiling for taxpayer support for public sector pension schemes. The Commission does not define the ceiling but says that if negotiations to bring costs within the ceiling are unsuccessful then there should be a default method for achieving this, presumably though increasing employee contributions. It is not clear how this fits with the expectation within the Comprehensive Spending Review that the Local Government Pension Scheme will contribute £900m to HM Treasury over the next three years (intended to be achieved through increasing employee contribution rates.)

In terms of implementing the proposed changes the Commission is very clear that it is **not** proposing a single public services pensions scheme, rather a common framework for public service pensions, which should also apply to LGPS which should remain a funded scheme.

The Commission also expresses the clear view that "it is in principle undesirable for future non –public service workers to have access to public service pension schemes" given that ultimately this places a financial risk with the tax payer as the financial backstop for these schemes. This recommendation has significant implications for the admitted body arrangements currently operated by LGPS Funds; particularly in relation to the contracting out of services where the

Government has recently announced the abolition of the "two tier" code relating to pension rights in outsourcing arrangements.

Governance and Transparency

The Commission makes a range of recommendations in relation to improving the overall system for managing pension provision in the Public Sector, although it acknowledges that LGPS Funds already exhibit considerable good practice in this area.

The specific recommendation is that a "properly constituted trained and competent Pension Board with member nominees" should oversee each scheme. In terms of LGPS this would create for the first time, a formal body at national level responsible for the scheme as a whole, while the existing local pension Committees would continue to operate the individual funds. In Lancashire the Committee already includes representatives of scheme members with voting rights.

The Commission is very clear that scheme members should be able to easily access information on the benefits which they are accruing. To support this they recommend the production of annual benefits statements and easy online access to information both of which have existed in Lancashire for some time.

The Commission considers it important that the performance of schemes and funds in terms of both administrative costs and investment should be regularly monitored and benchmarked while the long term cost of public service pensions should be regularly reviewed. The Lancashire County Pension Fund already regularly benchmarks costs and performance and in terms of scheme administration also makes comparisons with wider industry norms so this will not represent a significant change for the Fund.

The Commission also seeks to encourage the development of increased collaboration and sharing of services between LGPS funds. This is an area where Lancashire County Council is leading the way having recently taken responsibility for administering pensions on behalf of the Cumbria Pension Fund.

Implementation

The Commission suggests it would be helpful for the framework it is suggesting to be incorporated in new primary legislation with changes introduced before the end of the current parliament. It is also suggested that the implementation process should be centrally managed across all schemes.

There are also important details of the final schemes such as accrual rates and the automatic cost stabiliser which would need to be negotiated and consulted upon. Given all this it seems likely that any new scheme would only become operational around 2015 although considerable work will be required before this.

Conclusion

Given the content of the Commission's interim report there are no real surprises in this final report. The steps suggested will have some positive impact on the Fund's liability position but this would accrue over a very long timescale. The proposals also increase the risk of a reduced take up of scheme membership, which could significantly impact on investment strategy if it results in the Fund reaching maturity earlier than current actuarial forecasts indicate. The Local Government Association has been making ministers aware of this risk and has asked for it to be factored in to the negotiations around implementation. This is an area where the funded nature of LGPS creates different implementation risks from the other schemes and therefore different implementation strategies may be required.

The Chancellor of the Exchequer announced in the Budget that the Government fully accepts the Commission's report and will begin the process of negotiation on implementation later this year.

Pension Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected:
None

Transaction of Urgent Business

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

Executive Summary

A report on an item dealt with under the procedure for dealing with matters of urgent business.

Recommendation

The Committee is asked to note the action taken.

Background and Advice

Since the last meeting of the Committee, the following item has been approved under the urgent business procedure and after consultation with the Chair and Deputy Chair of the Committee:

Transition of Legal & General No 2 Portfolio

The County Treasurer and Treasurer to the Pension Fund has approved the transition of the Legal & General No 2 Portfolio to an interim management mandate. This would ensure that the funds with Legal & General were below the 35% limit specified in Pension Scheme Regulations.

Consultations

N/A

Implications:

This item has the following implications, as indicated:

Risk management

N/A

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

Paper	Date	Contact/Directorate/Tel
N/A	N/A	N/A

Reason for inclusion in Part II, if appropriate

N/A

Document is Restricted

(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)

Document is Restricted

(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)

Document is Restricted

(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)

Document is Restricted

(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)

Document is Restricted

(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)

Document is Restricted

(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)

Document is Restricted