

ABERDEEN CITY COUNCIL

COMMITTEE	Pensions Committee
DATE	29 September 2020
EXEMPT	No
CONFIDENTIAL	No
REPORT TITLE	Pensions Investment Strategy & Investment Performance Management
REPORT NUMBER	IA/AC2015
DIRECTOR	N/A
REPORT AUTHOR	Colin Harvey
TERMS OF REFERENCE	2.2

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the planned Internal Audit report on Pensions Investment Strategy & Investment Performance Management.

2. RECOMMENDATIONS

- 2.1 It is recommended that the Committee review, discuss and comment on the issues raised within this report and the attached appendix.

3. BACKGROUND / MAIN ISSUES

- 3.1 Internal Audit has completed the attached report which relates to an audit of the Pension Fund's Investment Strategy and Investment Performance Management.

4. FINANCIAL IMPLICATIONS

- 4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

- 5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

- 6.1 The Internal Audit process considers risks involved in the areas subject to

review. Any risk implications identified through the Internal Audit process are as detailed in the attached appendix.

7. OUTCOMES

- 7.1 There are no direct impacts, as a result of this report, in relation to the Local Outcome Improvement Plan Themes of Prosperous Economy, People or Place.
- 7.2 However, Internal Audit plays a key role in providing assurance over, and helping to improve, the Council's framework of governance, risk management and control. These arrangements, put in place by the Council, help ensure that the Council achieves its strategic objectives in a well-managed and controlled environment.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Impact Assessment	An assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. As a result, there will be no differential impact, as a result of the proposals in this report, on people with protected characteristics.
Data Protection Impact Assessment	Not required.

9. APPENDICES

- 9.1 Internal Audit report AC1923 – Pension Governance.

10. REPORT AUTHOR DETAILS

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Internal Audit Report

North East Scotland Pension Fund

Investment Strategy & Investment Performance Management

Issued to:

Steven Whyte, Director of Resources
Fraser Bell, Chief Officer – Governance
Jonathan Belford, Chief Officer – Finance
Laura Colliss, Pensions Manager
External Audit

EXECUTIVE SUMMARY

The North East Scotland Pension Fund (NESPF) and the Aberdeen City Council

Transport Fund (ACCTF), jointly known as the Fund, are administered by Aberdeen City Council. The NESPF was valued at £4.5 billion at the end of the 2018/19 financial year, and ACCTF had assets valued at £105 million.

In order to maintain, and where appropriate increase, the value of the Fund's assets in order to meet future liabilities as they fall due, and maintain the level of contributions appropriately, the Fund has set an Investment Strategy. This sets out a strategic portfolio allocation (between different classes or types of asset e.g. equities, bonds, credit, infrastructure) which each investment decision should aim to bring the Fund closer to achieving.

The Fund employs an internal Investment Management team, and uses external Investment Fund Managers, expenses for the services and performance of which currently amount to around £20 million per annum.

The objective of this audit was to provide assurance over compliance with the pension fund investment strategy and arrangements in place to monitor the performance of investment managers.

The Service regularly reports to the Pensions Committee on the allocation between funds, and performance of investment managers against benchmarks. However, there is limited narrative within the formal reports to explain what is being done, and over what timeframe, to address variations between actual and strategic allocations.

Performance reporting could be improved by monitoring and reporting against clear overall targets for the Pension Fund, tailoring the content of funds' narrative to the Fund's needs, separating out different assets held by the same Fund Manager, and disclosing the cost of performance by presenting net as well as the current gross performance figures. The Service considers that the Committee should not be overburdened with operational detail, and has highlighted that moves within the industry to improve cost transparency will take time to implement, but it will consider Internal Audit's recommendations in respect of performance reporting at the next review of Committee reporting by the Pensions Committee in March 2021.

The Investment Policy sets out that Fund Managers' performance will be reviewed, discussed, and reported to Committee where underperformance is identified. There is no written procedure to set out how reviews should be carried out, and review activity and discussions are not documented. The Service does not intend to do so due to resource constraints.

Final investment proposals, and approval under delegated powers by the Chief Officer – Finance, are adequately documented, however the supporting options appraisal and selection processes leading up to this point are not. It is not therefore possible to obtain assurance that these decisions are being taken on the basis of all appropriate information. Substantial reliance is placed on individual officers to select and compare appropriate investments. There is no evidence of key controls including written procedures, segregation of duties, and declarations of interest. There were similar findings in respect of recording consideration of options for disinvestment. The Service has agreed to develop its processes during 2020.

At the time audit fieldwork took place the Fund was cashflow positive, and over 100% funded. Cash balances may be up to 2.5% of the value of the Fund, under the current Investment Strategy. The Service regularly monitors its cash balances, but does not consider it appropriate, necessary, or achievable to prepare and use cashflow forecasts. It will however set cash management principles to guide decision making in this respect.

Surplus cash may also not provide the best value return. The Service does not document its discussions and options in respect of cash deposits. The majority of cash balances are invested in the Aberdeen City Council's Loans Fund. The year-end accounts for 2018/19 show cash holdings with Aberdeen City Council of £107m / 2.4% of the Fund value at the time. The Service considers this the best returning solution providing the required liquidity, but has agreed to review its options for short term cash deposits, and to document its arrangements more clearly to demonstrate that they remain appropriate.

1. INTRODUCTION

- 1.1 The North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF), jointly known as the Fund, are administered by Aberdeen City Council.
- 1.2 The NESPF was valued at £4.5 billion at the end of the 2018/19 financial year, and ACCTF had assets valued at £105 million.
- 1.3 The Funds are built up from contributions from both employees and employing bodies, together with interest, dividends, and rent from investments, out of which pensions and other benefits are paid. Employee contributions are fixed by statute while employer contributions are assessed every three years by an independent Actuary to determine the level of contributions necessary by employing bodies to ensure that the Funds are able to meet future benefits as they fall due.
- 1.4 In order to maintain, and where appropriate increase, the value of the Fund's assets in order to meet future liabilities as they fall due, and maintain the level of contributions appropriately, the Fund has set an Investment Strategy. This sets out a strategic portfolio allocation (between different classes or types of asset e.g. equities, bonds, credit, infrastructure) which each investment decision should aim to bring the Fund closer to achieving.
- 1.5 The Fund employs an internal Investment Management team, at a cost of around £200,000 per annum, and uses external Investment Fund Managers, expenses for the services and performance of which currently amount to around £20 million per annum. Fees vary depending on the type of investment, and performance as measured by the size and growth of assets allocated to a Manager as compared with relevant benchmarks. An Investment Management Consultancy has been appointed, and fees are payable where consultants are engaged to provide advice or conduct research.
- 1.6 The objective of this audit was to provide assurance over compliance with the pension fund investment strategy and arrangements in place to monitor the performance of investment managers. This involved review of procedures and documented practice in respect of management by the Service of a sample of investments.
- 1.7 The factual accuracy of this report and action to be taken with regard to the recommendations made have been agreed with Laura Colliss – Pensions Manager and Jonathan Belford – Chief Officer, Finance.

2. FINDINGS AND RECOMMENDATIONS

2.1 Investment Strategy

- 2.1.1 Although it is longer term than this, the Strategy is formally reviewed every three years in line with the Actuarial Valuation (next due as at March 2020). It was last reviewed in March 2018 (following the 2017 Valuation). The Strategy is agreed by the Committee, and consideration is given to it at each quarterly Committee meeting. The frequency and level of reviews is reasonable and appropriate.
- 2.1.2 The Strategy sets out the strategic allocation of funds ('strategic benchmark') between different asset classes / categories. The aims are to restore any Fund deficit position through investment returns and agreed contributions, and to provide a framework for identifying changes required over the coming period to continue and maintain the appropriate funding level – in order to meet the Fund's ongoing financial obligations in perpetuity.
- 2.1.3 The 2017 Valuation demonstrated that the funding level was 107%, and the strategy was therefore amended to protect this position – to de-risk and lock in gains, by reducing the growth asset allocation (equities), increasing income / protection (bonds and credit), and introducing a new Infrastructure allocation. Further movements in the strategic benchmark were set out up to 2027, 'if and when funding levels and market conditions allow'.
- 2.1.4 Whilst not explicitly referenced in the Strategy, the Statement of Investment Principles sets out that the Fund seeks to maintain a 100% solvency level, by achieving a return of CPI + 1.75% through adherence to the strategy benchmark allocation, with a mix of passive and active investment portfolios.
- 2.1.5 The 2018 Investment Strategy Review noted that movements towards the planned strategic allocation would be phased over time taking into account trigger points and market conditions. The trigger points were not set out in advance, and the periods over which they might be achieved were noted as indicative only.
- 2.1.6 Reports have been taken to the Committee in respect of alternative plans (though this is not reflected in a change to the Strategy), and investment opportunities, which will when implemented allow the Fund to move towards the strategic allocation for certain asset categories. The Service considers that setting a timescale for full compliance would be inappropriate as it depends on availability and timing of appropriate alternative investments to move into, and existing ones to move out of. For Funds there can be delays between agreeing to go ahead, and the funds actually being drawn down. Setting arbitrary targets could be counterproductive and not conducive to making sound investment decisions.
- 2.1.7 Compliance with the Strategy is monitored as part of the investment management reporting which goes to each Committee meeting. Whilst regular monitoring indicates activity and consideration of aspects of performance information, there is limited narrative in the financial update on compliance or otherwise with the Strategy, and progress towards achieving the planned allocation. More regular and consistent detail on movement towards the Strategy would provide more assurance to the Committee that management is taking appropriate action.

Recommendation

The Service should review reporting to demonstrate that management is taking appropriate action to move towards greater alignment with the Strategic allocation.

Service Response / Action

Agreed.

<u>Implementation Date</u> March 2021	<u>Responsible Officer</u> Pension Fund Manager	<u>Grading</u> Significant within audited area
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2.2 Investment Practice

- 2.2.1 The Pensions Committee terms of reference set out that its purposes include to set the investment objective and strategy in light of the Fund's liabilities and appoint or remove Fund Managers or new vehicles in furtherance of the strategy, and to monitor the performance of Fund Managers.
- 2.2.2 Powers delegated to Officers in 2018 provide the Chief Officer – Finance with the power to implement investment arrangements for the Fund in accordance with the Local Government Pension Regulations, including sourcing and appointment of investment fund managers within the approved Strategy. Therefore, only decisions anticipated by Officers to move beyond the approved Strategy require Committee approval. As there is no requirement to report back to Committee on changes to the portfolio, reliance is placed on Officers to ensure their decisions are aligned with the Strategy.
- 2.2.3 Investment decisions are based on available options which are aligned with the Investment Strategy – i.e. if the Fund is underweight in a particular category / asset allocation, the Service will give more consideration to available options within that category.
- 2.2.4 Where it is identified that new or revised investments are required to better align with the Strategy, the Investment Manager reviews and discusses the current and proposed strategic allocation with the Pensions Manager and Chief Officer – Finance at a summary level. Proposals, and agreement to proceed to shortlisting options, are not formally documented, though records are retained of the anticipated movement between asset classes – demonstrating the planned changes to the portfolio. The source and reasoning for changing the balance of investments are sufficiently detailed for a decision to be made on these, though no decision is recorded at this stage. However, the decision on how much to invest in any particular option is not clearly documented.
- 2.2.5 There is no documented options appraisal process. Investigation is undertaken into available options, based on the Investment Manager's professional judgement and market awareness – informed by the professional press, and networking with service providers. Options may also be selected from current or previous research conducted by the Fund's investment consultants, if considered by the Investment Manager to be sufficiently related and recent.
- 2.2.6 Options are shortlisted by the Investment Manager, and thereafter compared on key criteria. No evidence is retained of the shortlisting process, or the basis of assumptions and sources of data used in determining comparisons except where documented in investment sales material. Some supporting data was held for two out of three investments for which records were requested by Internal Audit. There is no record of this being shared with key decision makers as part of the governance process. For the third investment the Service considered that research by the Fund's investment consultants sufficiently made a case for selection of the preferred option, though the Fund Manager selected had not featured in the consultants' analysis completed over six months previously. There is no written protocol regarding obtaining advice. Advice is obtained where the Investment Manager considers it appropriate to do so. Obtaining advice could provide independent assurance over the option appraisal process, but will represent an additional cost and could potentially delay decision making pending research being carried out and reported.
- 2.2.7 Whilst the reasons for selecting one option over other shortlisted options can be deduced from the summary of criteria retained, there is no formal ranking of options according to the key criteria recorded, and therefore no objective assurance that the best option has been selected.

2.2.8 Although the Investment Manager has stated that the shortlisted options are discussed in detail with the Pensions Manager and Chief Officer – Finance, only the preferred option is put forward in an investment decision pack for approval. Although more than one officer is named in the report, there is no record of proposals having been approved by a second officer, prior to it being put forward for Chief Officer approval. The Chief Officer – Finance is not provided with a full options appraisal to inform their decision. Without this they are being asked to place full reliance on other Officers to have presented the best option.

2.2.9 Should a proposal which has been erroneously selected or deliberately misrepresented be presented for approval, it is unlikely that present controls would identify and address the error. Clear procedures and independent checks against objective evidenced data would provide more assurance of accuracy and reduce the risk of fraud.

Recommendation

The Service should document the processes involved in developing and taking forward investment proposals. This should include:

- Methods used for determining appropriate investment amounts
- Methods used for shortlisting potential investments
- Circumstances in which consultants use should be considered
- A clear options appraisal before finalising investment proposals
- A documented review and sign-off process prior to being submitted to the Chief Officer – Finance for approval.

Service Response / Action

Agreed.

Implementation Date

December 2020

Responsible Officer

Pension Fund Manager

Grading

Major at a Corporate Level

2.2.10 There is a conflicts of interest document, but with limited exceptions it only covered Committee and Board Members. Whilst such a document is reliant on self-declaration, it can serve to protect officers from allegations of bias, and inform decision makers to allow risk avoidance controls to be implemented.

Recommendation

The Service should ensure all Officers involved in preparing and reviewing investment proposals have completed declarations of interest.

Service Response / Action

Agreed.

Implementation Date

December 2020

Responsible Officer

Pension Fund Manager

Grading

Significant within audited area

2.2.11 The Service regularly monitors its 'cash' balances, as these are not generally contributing to asset growth in line with the Strategy. Where considered appropriate by the Service, cash balances may be temporarily invested by the Council's Treasury Management section. However, there is no regular cashflow forecasting. Day to day receipts and payments are largely in balance, meaning there are few anticipated changes in cash balances, except where changes to investments have been planned, or existing commitments are drawn down – which are generally at short notice, making planning and forecasting more difficult to complete accurately.

2.2.12 Although detailed cashflow forecasting may not currently be necessary, due to the current funding position, should this change a clear procedure would provide more assurance that the appropriate decisions were being made and approved at the correct level. There is a risk that without sufficient forecasts the Service may have to respond reactively rather than proactively to cash variances, which could incur additional cost. High-level forecasts reflecting key assumptions would provide some assurance that the risk has been given appropriate consideration.

Recommendation

The Service should develop proportionate cashflow forecasting procedures.

Service Response / Action

Cashflow forecasting is considered to be disproportionate to the Fund's requirements, however cash management principles will be set out, covering e.g.: the likely order of disinvestment; what happens when we sell in an unexpected or unplanned situation; and how we avoid unexpected transactions.

Implementation Date

December 2020

Responsible Officer

Pension Fund Manager

Grading

Important within audited area

2.2.13 Surplus cash, where held centrally and not with Investment Fund Managers, is normally 'invested' in the Council's Loans Fund by default, at the Bank of England base rate – which the Service considers to represent the best value option. There is no documented analysis of options in this regard. The year-end accounts for 2018/19 show cash holdings with Aberdeen City Council of £107m / 2.4% of the Fund value at the time. The Service has stated that this is within the 2.5% 'other' category (which is largely cash) within the strategic allocation.

2.2.14 The Service indicated its bank was selected by the Council (as part of its own set of accounts), and therefore it is likely to offer similar terms and interest direct as that paid by the Council. Although convenient, 'investing' funds with the Council is unlikely to be significantly different from the rates available from the Fund's bank for overnight or short-term deposits. With better forecasting (see above) funds could be let for an extended period to obtain more favourable returns. Although 2.4% of the total Fund value may not seem material, only six of sixteen Investment Fund Managers managed a larger proportion of the Fund value at 31 March 2019.

2.2.15 However, using the Council's banking arrangements will reduce the cost of administering cashflow as the risks and rewards are passed to the Council. I.e. the Council can benefit from investment returns or lower borrowing costs on the amount held, but bears the cost of treasury management operations and the risk of having to draw down or borrow funds in order to make payments to NESPF as they fall due. It may be that as the Fund develops its in-house investment portfolio, which is planned, there will be a more active role for the Service in managing cashflow. The Service has indicated that liquidity is the key requirement for the Fund, which this arrangement offers.

2.2.16 Internal Audit highlighted to the Service that the Pensions Act 1995 states that the Fund must not invest in or provide loans to any of its Employer Organisations, and that this arrangement could be seen as doing so. The Service has taken legal advice, which indicates that it is not in breach of its statutory obligations, but that the arrangements should be more formally documented to reinforce this position.

Recommendation

The Service should review options for short term cash deposits, and improve documentation regarding investments made with the Council.

Service Response / Action

Agreed.

Implementation Date

December 2020

Responsible Officer

Pension Fund Manager

Grading

Significant within audited area

- 2.2.17 The Service has stated that it does not generally disinvest for cashflow purposes. This is not generally required due to day to day receipts and payments being largely in balance. Instead, it will disinvest to crystallise / capitalise on gains, in order to adjust the strategic allocation or invest in alternative assets.
- 2.2.18 It has however disinvested to capitalise on gains, and retained this as cash in some instances, in order to fund future drawdowns (e.g. infrastructure and direct lending) – which may have limited notice, and to protect against future risks (e.g. Brexit).
- 2.2.19 There is no detailed analysis of which investments were appropriate for selection to secure current gains. The Investment Manager stated that in respect of the most recent sale (to fund investment in credit to rebalance the strategic allocation) the equity reduction proposed was from the top 20 stocks, which accounted for over 60% of the specific fund value (which had approximately 100 stocks in total). How and to what extent these were reduced was not available.
- 2.2.20 Although disinvestment for cashflow purposes may not currently be necessary, due to the current funding position, should this change a clear protocol would provide more assurance that the appropriate decisions were being made and approved at the correct level. Detailed selection of investments for sale is not well recorded. Clearly recording the selection process would provide justification for disposal of assets.

Recommendation

The Service should develop a protocol to cover selection and recording of disinvestment options.

Service Response / Action

Agreed. The actions agreed at 2.2.12 will document the principles to be applied for disinvestment.

Implementation Date

December 2020

Responsible Officer

Pension Fund Manager

Grading

Significant within audited area

2.3 Performance Monitoring

- 2.3.1 Performance reports are received quarterly from Fund Managers, compared with other available information, considered by the Investment Manager, challenged where appropriate, and presented to the Pensions Committee.
- 2.3.2 The same approach is taken in monitoring each Fund Manager / portfolio, though the way in which performance is reported is determined by each Fund Manager. Each reports their performance in a slightly different format.
- 2.3.3 There are no written procedures in place for monitoring performance, and the actions taken and discussions with Fund Managers are not recorded. Setting out performance monitoring procedures would provide more assurance over consistency and proportionality.

Recommendation

The Service should set out performance monitoring procedures.

Service Response / Action

Not agreed.

Following the internal audit report on Pension Governance in March 2019 the Fund agreed to recommendations 2.5.1 and 2.5.2 regarding performance management. This resulted in The Investment Policy document being updated, detailing monitoring and review process. (June 2019).

Resource constraints are such that assurance on performance monitoring comes from the task being assigned to the Investment Manager and team and these being requirements of the job profiles. The reporting requirements that are informed by the discussions and information provided by Fund Manager and an understanding that each Fund Manager mandate is different such that it may require a different set of performance data.

Internal Audit Position

The revised Investment Policy referenced sets out that performance will be reviewed, and underperformance will be discussed with Fund Managers and reported to Committee. The internal processes for doing so are not set out in a procedure, and the discussions are not documented. It is not therefore possible to obtain assurance that performance monitoring is being completed and acted on appropriately.

Implementation Date

N/A

Responsible Officer

Pension Fund Manager

Grading

Important within audited area

- 2.3.4 Fees are typically based on market values and in some cases an additional performance fee based on outperforming targets or benchmarks. Funds generally have their own benchmarks or targets, and in most cases these are set out in the Investment Management Agreements (or equivalent) between the Fund Manager and NESPF, along with details of the basis and calculation of fees and charges. These may be subject to change following renegotiation of terms – which are also documented.
- 2.3.5 As NESPF generally buys in to a Fund Manager’s investment approach, existing investment option, or new proposal, there is limited opportunity to set or influence the selected benchmarks and terms. NESPF would have to change providers, set up its own Funds or act collectively with other investors to set or change targets.
- 2.3.6 Not all funds have a benchmark recorded in the agreement – Partnership agreements / Private funds do not generally list a benchmark. Fees for these are typically deducted directly from funds, providing limited opportunity for review.
- 2.3.7 For the majority of Funds, assets are listed on a relevant exchange, and therefore performance data is published. The Global Custodian provides independent confirmation of quarterly valuations for these. Where there are variations beyond agreed tolerances, the Investment Manager seeks further information and will challenge the data where necessary. For unlisted assets, assurance has to be taken from the Fund Manager, each of which is subject to its own audit and inspection arrangements.
- 2.3.8 The Service maintains a list of all fees as part of its contracts register. Whilst in general this is up to date and includes links to all of the relevant documents, it did not include detail of the fees payable on all of the funds with each Fund Manager. An error was also identified where the fee

was stated as being applicable to the first £1 million when it should be £100 million.

- 2.3.9 The register also sets out where IFM's hold Power of Attorney (PoA) on behalf of NESPF for efficient functioning of the portfolio – i.e. acting on behalf of NESPF to sign investment documentation, or such other powers as may be requested and set out in the Investment Management Agreement or equivalent. Two instances relating to Partnership agreements for pooled investments which included PoA's were not recorded on the register.
- 2.3.10 Documentation of investment management agreements is voluminous and incorporates various amendments. There is a risk that if changes are not documented and summarised, they may not be applied correctly, or challenged appropriately if the changes are not applied. The fees section of the contracts register should include all fees to inform checks against fees levied by IFM's.

Recommendation

The Service should ensure the fees section of the contracts register is complete and accurate.

Service Response / Action

Agreed. The Fund will ensure the register is accurate, however there is no material risk to the Fund

Implementation Date

September 2020

Responsible Officer

Pension Fund Manager

Grading

Important within audited area

- 2.3.11 Fee calculations are checked by staff before payment is agreed, and annotated to confirm reviews have taken place. A sample of fees was reviewed and in each case the amounts paid to / deducted from funds by the Fund Manager matched the relevant agreements.
- 2.3.12 Monitoring generally only covers financial performance – though the Service does seek ESG (Environmental, Social and Governance) information and has sought to include it, with Fund Manager approval, in Committee reports. No standards have been set, therefore it would be difficult to measure performance on these aspects. At the time of the audit fieldwork, not all Fund Managers regularly provided ESG information, and it was not available for the Private Markets funds.
- 2.3.13 The Statement of Investment Principles and Corporate Governance and CSR (Corporate Social Responsibility) Policy indicate that a level of monitoring, and active voting arrangements, are in place regarding ESG performance. However, there are no set requirements in terms of the level of activity or assurance required by the Fund in respect of ESG (except in respect of the Fund's voting activity on its active portfolio).
- 2.3.14 The Service has stated that ESG related information is now being obtained and reported, however there are challenges for some alternative asset managers. While ESG has been an integral part of the LGPS and asset management for many years, the ability to measure in a consistent and relevant way is still a challenge for the industry across all asset classes. These challenges were discussed in detail at a recent training event for the committee and board, and while the industry continues to address and improve this will take time for a holistic solution to evolve.
- 2.3.15 However, in the absence of targets / clearly defined expectations and consistent reporting requirements it will be difficult to effectively monitor this dimension of the Fund's performance.

Recommendation

The Service should review its ESG policies and reporting requirements.

Service Response / Action

Agreed.

Implementation Date

March 2021

Responsible Officer

Pension Fund Manager

Grading

Important within audited area

2.4 Performance Reporting

- 2.4.1 There is regular performance reporting to the Pensions Committee. Performance information including the value and proportion of the fund held with each Investment Fund Manager, performance of each Manager against a benchmark, and commentary from each Manager is provided in Asset and Investment Manager Performance reports presented to each Committee meeting.
- 2.4.2 A summary table outlines the movement in funds over the last Quarter with each Investment Fund Manager, the total value of the fund, and a comparison between the current and strategic allocation between the different asset classes. There is no commentary on the latter – see section 2.1 above.
- 2.4.3 Some Managers have more than one fund / asset allocation. Whilst this is reflected in the report there is no indication of the value / proportion to which the benchmark and commentary relates for each fund. Figures could be made clearer by including the value of each portfolio where Fund Managers hold more than one.
- 2.4.4 Figures in the summary table do not show the percentage change in value of each fund over the reporting period, though this and longer-term performance against benchmarks are shown in later sections.
- 2.4.5 All fund movements and performance figures are shown gross. Fees are calculated at a later date, and reported as a single figure – i.e. not by Investment Fund Manager or fund / asset. The Service considers this to be commercially sensitive information and has stated that it would be difficult to estimate the level of fees in advance sufficiently accurately to include in performance reports. However, presenting data gross (before fees) could be misleading, as actual returns are net of fees – which will reduce and could exceed any gains made. It is therefore not possible to gauge performance and value for money based on gross figures alone.
- 2.4.6 There is limited management commentary on performance – the narrative content of the report is largely derived from Fund Managers reports which contain generic economic commentary and Managers' selected portfolio highlights. Since June 2019, following implementation of an Internal Audit recommendation, the Service makes it clear that the commentary is from Fund Managers. Whilst generally this provides suitable market and portfolio information, more tailored data would provide further assurance to the Committee over specific asset performance.
- 2.4.7 A traffic light system is used to highlight whether Fund Managers' performance is within acceptable tolerances. Additional information is also available to Committee members through a secure area on the NESPF website which hosts quarterly Investment Manager reports. Whilst the Committee is able to obtain management commentary and further assurance during its meetings, this is not specifically recorded in the minute unless a decision is being sought.
- 2.4.8 The Private Equity section of the report is in a different format, and where printed is difficult to read. Whilst it includes more information than is available for other assets / funds, there is

minimal commentary to put these in context.

2.4.9 The Service has started obtaining ESG / Responsible Investment information from Fund Managers, though not all have provided and agreed the release of this information to the Committee. Where it has been obtained, highlights are reported in respect of their engagement with individual companies / equities on specific issues. The Service also reports its voting activity (for equities it holds in its 'active' portfolio) in a register retained on the NESPF website. Voting is informed by LAPFF (Local Authority Pension Fund Forum) and PIRC (Pensions & Investment Consultants Ltd) recommendations – which give consideration to ESG issues. As noted in section 2.1 above there are no set requirements or targets for the non-financial performance elements of the reports.

2.4.10 Decisions at an individual investment / fund / asset level are largely made by Officers under delegated powers (see section 2.2 above), therefore the scope for Committee decision making is appropriately limited to strategic and policy decisions. However, the way in which information is currently provided limits the Committee's ability to scrutinise and where appropriate challenge Officers' decisions and performance. The format of reporting could be improved to provide additional and more useful information to the Committee as discussed in this section.

Recommendation

The Service should review performance reporting to ensure:

- data is tailored to the Fund's needs;
- valuation and performance data is sufficiently separated for different assets held by the same Manager;
- performance measurement reflects costs;
- the Committee is able to scrutinise and challenge Officers' decisions and performance as appropriate.

Service Response / Action

Agreed

Reporting to committee is and should be at a strategic level not operational. The committee is provided with both the Fund Managers commentary and officers provide further comments during the committee meetings detailing any significant and or strategic issues or change.

The industry standard is to report on gross performance numbers, some Fund Managers do however report net, it is not possible at present to provide true net numbers.

There is currently mounting pressure on the industry to clearly report on all costs, while we monitor and work with the industry to be more transparent this will take time.

Officers currently work and provide reporting under agreed delegations and additions or change to assets are discussed and reported to committee.

Committee reporting is regularly reviewed and discussed by committee, officers are steered by council as to the level of content in committee reporting ensuring it remains concise and strategic.

Recommendations will be considered at the next review of committee reporting by the Pension Committee

Implementation Date

Review date: March 2021

Responsible Officer

Pension Fund Manager

Grading

Significant within audited

area

AUDITORS: D Hughes
C Harvey

Appendix 1 – Grading of Recommendations

GRADE	DEFINITION
Major at a Corporate Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss, or loss of reputation, to the organisation.
Major at a Service Level	<p>The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss to the Service/area audited.</p> <p>Financial Regulations have been consistently breached.</p>
Significant within audited area	<p>Addressing this issue will enhance internal controls.</p> <p>An element of control is missing or only partial in nature.</p> <p>The existence of the weakness identified has an impact on a system's adequacy and effectiveness.</p> <p>Financial Regulations have been breached.</p>
Important within audited area	Although the element of internal control is satisfactory, a control weakness was identified, the existence of the weakness, taken independently or with other findings does not impair the overall system of internal control.