Shetland Islands Council

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Director of Corporate Services: Christine Ferguson

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If calling please ask for
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Date: 1 May 2019

Dear Sir/Madam

You are invited to the following meeting:

Pension Fund Committee / Pension Board
Council Chamber, Town Hall, Lerwick
Thursday 9 May 2019 at 10am

Please note that in accordance with the agreed terms of reference, this is a concurrent meeting of both the Pension Fund Committee and the Pension Board - SEE MEMBERSHIP OF BOTH BODIES OVERLEAF

Apologies for absence should be notified to Louise Adamson at the above number.

Yours faithfully

Executive Manager – Governance and Law

Chair: Steven Coutts

AGENDA

(a) Hold circular calling meeting as read.

(b) Apologies for absence, if any.

(c) Declarations of Interest – Members are asked to consider whether they have an interest to declare in relation to any item on the agenda for this meeting. Any Member making a declaration of interest should indicate whether it is a financial or non-financial interest and include some information on the nature of the interest. Advice may be sought from Officers prior to the meeting taking place.

(d) Confirm the minutes of the meeting held on 5 March 2019, enclosed.

ITEMS

1. Management Accounts for Pension Fund Committee: 2018/19 – Draft Outturn
F-030

2. Pension Fund Management Annual Investment Review 2018/19
F-034

Pension Fund Committee
A Cooper S Coutts S Leask E Macdonald R McGregor I Scott G Smith T Smith R Thomson

Pension Board	
Employers Representatives: M Bell, SIC J Fraser, SIC A Hawick, SIC J Johnston, SRT Joint Secretary J Riise, Executive Manager – Governance and Law	**Trade Union Representatives**: D Marsh, Unison A Goudie, Unite R Williamson, GMB A Taylor, Unison *Substitutes*: *C Wiseman, Unison* Joint Secretary C Wiseman, Unison

Shetland
Islands Council

(d)

MINUTES

A&B - Public

<table>
<tr><td>Pension Fund Committee
Council Chamber, Town Hall, Lerwick
Tuesday 5 March 2019 at 1.30pm

Present - Members:
A Cooper S Coutts
S Leask E Macdonald
I Scott G Smith
T Smith R Thomson

<u>Apologies:</u>
R McGregor
R Thomson (for lateness)</td><td>Pension Board
Council Chamber, Town Hall, Lerwick
Tuesday 5 March 2019 at 1.30pm

Present - Members:
M Bell J Fraser
A Hawick J Johnston
D Marsh

<u>Apologies:</u>
A Taylor</td></tr>
<tr><td colspan="2">In Attendance:
J Manson, Executive Manager – Finance
J Riise, Executive Manager – Governance and Law
M Smith, Team Leader - Expenditure
C Bain, Treasury Accountant
S Brown, Senior Assistant Accountant
A MacIver, Assistant Accountant
L Adamson, Committee Officer

<u>Also in Attendance</u>:
K Jupp, Blackrock
J Griffith, KBI Global Investors
G Maher, KBI Global Investors</td></tr>
</table>

Chair
Mr Coutts, Chair of the Pension Fund Committee presided.

Circular
The circular calling the meeting was held as read.

Declarations of Interest
None

Minutes
Subject to the following, the minutes of the meeting held on 5 December 2018 were confirmed on the motion of Mr Leask, seconded by Mr Scott.

23/18 - Scottish LGPS Restructure Review – Consultation Final Response
During the debate, the reference to “union and staff representatives”, should read “Admitted Body representatives”.

01/19 **Presentation by KBI Global Investors**

The Chair welcomed Mr Griffith and Mr Maher to the meeting.

Mr Griffith and Mr Maher gave a presentation entitled "KBI Global Investors – Equity Strategies" (copy of the handout attached as Appendix A). The presentation provided an overview of the company, and informed on the management of funds investing over the longer-term. Members of the Committee and Board were advised that the most recent value of the fund was £101m, compared to £68m at the date of inception in December 2014.

(Mr Thomson attended the meeting).

During the discussion, and in response to questions, Mr Maher advised on the three-step systematic monthly process carried out by KBIGI, checking for any changes to be made in stocks to ensure investments are performing to generate returns. He advised that 6.8% would be considered the normal return from equities, which he said was an attractive return compared to some of the different asset classes.

The Chair thanked Mr Griffith and Mr Maher for the update provided.

02/19 **Presentation by BlackRock**

Ms Jupp, Blackrock, gave a presentation entitled "Shetland Islands Council Pension Fund" (copy of the handout attached as Appendix B). The presentation included an overview of Blackrock, and informed on the Pension Fund's investments split between the UK and global allocation in passive funds, focusing on relative return. It was noted that the value of the Fund at 31 December 2018 was £193m. During the presentation, Ms Jupp reported on the very challenging year for the markets during 2018, particularly in the last quarter, however she said that the outlook for 2019 was more positive.

(Mr Cooper attended the meeting).

In response to questions, Ms Jupp advised on the benefit of continually holding an allocation of cash within the Fund. She also advised on the impact of inflation in terms of stability on the UK equity markets. There were no further questions, and the Chair thanked Ms Jupp for the information provided.

03/19 **Management Accounts for Pension Fund Committee: 2018/19 Projected Outturn at Quarter 3**

A report by the Executive Manager – Finance (F-013), enabled the Committee and Board to monitor the financial performance of the Pension Fund to ensure Members are aware of the forecast income and expenditure position and its impact on delivery of the approved budget.

The Executive Manager – Finance summarised the main terms of the report.

In responding to a question on the projected overspend position at Quarter 3, the Executive Manager – Finance advised that the main variances related to the value of lump sums payable and retirements. He added that in any year the budget can be exceeded or underspent by a number of factors, and while this was difficult areas to predict, it was manageable and not out with expectations.

In response to a question, the Team Leader – Expenditure advised that the income from early retirements where strain cost payments have been made by the service would be included in the figure at "contributions received". She added that for this year there have been two such retirements, however only one had a strain cost to be paid to the Pension Fund, with the other meeting the Rule of 85.

There were no further questions, and the Committee and Board noted the report.

Decision:

The Pension Fund Committee and Pension Board **NOTED** the Management Accounts showing the projected outturn position at Quarter 3.

04/19 **Pension Fund – Quarter to December 2018 Investment Review Report**

The Committee and Board considered a report by the Executive Manager – Finance (F-021) that presented the investment position and performance of the Pension Fund's external investments, managed by Fund Managers, for the quarter to December 2018.

In introducing the report, the Executive Manager – Finance commented on the mixed performance from Fund Managers during the 3rd quarter. He also reported that the outcome from the review of the Pension Fund Investment Strategy could result in changes to the investments in the future.

In response to a question, the Executive Manager – Finance advised on the proposed timescale for a response following the consultation on the Scottish Local Government Pension Scheme Restructure review.

There were no further questions, and the Committee and Board noted the report.

Decision:

The Committee and Board **NOTED** the contents of the report.

05/19 **Annual Audit Plan 2018/19**

The Committee and Board considered a report by the Executive Manager – Finance (F-018) that presented the Annual Audit Plan for the 2018/19 financial year by the Pension Fund's external auditors, Deloitte LLP.

The Executive Manager – Finance introduced the report. There were no questions, and the Committee and Board noted the report.

Decision:

The Committee and Board **NOTED** the contents of the Audit Plan 2018/19 for Shetland Islands Council Pension Fund from external auditors, Deloitte LLP.

06/19 **2019/20 Budget Proposal – Pension Fund**

The Committee and Board considered a report by the Executive Manager – Finance (F-014) that presented the proposed Pension Fund budget for 2019/20.

In introducing the report, the Executive Manager – Finance advised on the range of assumptions taken into account when setting the pension fund budget for 2019/20.

In response to a question, the Executive Manager – Finance advised on the expectation that the Pension Fund would be fully funded by 2027.

There were no further questions. During debate, reference was made to a key issue listed at Section 4.1, being the assumption that all admitted bodies would be awarding the 3% pay increase to staff.

On the motion of Mr Coutts, seconded by Mr Leask, the Committee moved the recommendation in the report.

The Pension Board noted the report.

Decision:

- The Pension Fund Committee **RESOLVED** to approve the budget proposals for 2019/20.
- The Pension Board NOTED the report.

07/19 **Shetland Islands Council Pension Fund – Training Policy**

The Committee and Board considered a report by the Executive Manager – Finance (F-024) that presented the Training Policy for the Shetland Islands Council Pension Fund.

The Executive Manager – Finance summarised the main terms of the report.

In response to a question regarding the training arrangements at section 5.3 of the Policy, the Executive Manager – Finance reported on the expectation that Committee and Board Members would attend at least two training events and three out of the four formal joint meetings annually, in order for Members to fulfil their duties on the Pension Fund Committee/Board.

During the discussion, it was suggested that a list of training dates for the year ahead would be advantageous to allow Members to plan in early course for their attendance at the training events.

It was advised the arrangements were being made for the Fund Actuary, Hymans Robertson, to provide a training session at the next meeting on 9 May 2019. In that regard, Members were encouraged to relay any particular areas of focus that could be covered in the training session.

During debate, Mr Coutts commented that he welcomed the training policy, advising on the importance for Members have the appropriate level of knowledge going forward. Mr Coutts moved that the Committee approve the recommendation in the report. Mr Thomson seconded.

The Pension Board noted the report.

Decision:

The Pension Fund Committee **RESOLVED** to approve the Training Policy.

The Pension Board noted the report.

(Ms Hawick, Mr G Smith and Mr T Smith left the meeting).

08/19 **Pension Fund Risk Register**

The Committee and Board considered a report by the Executive Manager - Finance (F-026), which provided up to date information on the risks associated with the Council's Pension Fund.

In introducing the report, the Executive Manager – Finance highlighted the two risks where the scores had recently changed, as set out in Section 4.7.

In responding to a question, the Executive Manager – Finance said that depending on the outcome of the consultation, the Local Government Pension Fund Restructure review would be added as a risk on the Risk Register.

During the discussion, reference was made to Risk No.13 on the Risk Register, "Funding – Employers leaving the scheme/closing to new members due to cost of cessation". Comment was made on the significance of this risk, and while it was noted the risk was currently ranked as 'high' it was questioned whether this was an area where additional focus was required. The Executive Manager – Finance advised on the safeguards in place to protect the Fund should admitted bodies come out of the Scheme. Mr Johnson referred to the meeting last year with representatives of the Admitted Bodies which he said had been very useful and beneficial, and he questioned whether a similar meeting was proposed for this year. During further discussion, it was proposed that a meeting with representatives of the Admitted Bodies would be arranged when the Fund Actuary was in Shetland in May 2019. Mr Johnston was asked to provide a list of questions to focus discussion.

There were no further discussion, and the Committee and Board noted the report.

Decision:

The Pension Fund Committee and Board **NOTED** the content of the report and the current Risk Register.

09/19 **<u>Pension Fund Committee and Pension Board Business Programme - 2019/20</u>**

The Committee and Board considered a report by the Executive Manager - Finance (F-025), which informed of the planned business to be presented to the Committee/Board to 31 March 2020.

The Executive Manager - Finance introduced the report, and the business programme at Appendix 1.

There were no questions, and the Committee and Board noted the report.

Decision:

The Pension Fund Committee and Board noted the planned business for financial year 1 April 2019 to 31 March 2020 as set out in the Business Programme.

The meeting concluded at 3.20pm.

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Chair

Shetland Islands Council

Agenda Item
1

Meeting(s):	Pension Fund Committee Pension Board	9 May 2019
Report Title:	Management Accounts for Pension Fund Committee: 2018/19 – Draft Outturn	
Reference Number:	F-030-F	
Author / Job Title:	Jamie Manson, Executive Manager - Finance	

1.0 Decisions / Action required:

1.1 That the Pension Fund Committee and Pension Board RESOLVES to note the Management Accounts showing the draft outturn position for 2018/19.

2.0 High Level Summary:

2.1 The purpose of this report is to enable the Pension Fund Committee and Pension Board to note the financial performance of the Pension Fund for the 2018/19 financial year. This report shows the draft outturn of the Pension Fund for 2018/19, and is subject to final accounting and audit adjustments as part of the year-end accounts process.

2.2 The draft revenue outturn position for the Pension Fund for 2018/19 is an under-achievement of £991k (14.7%), which means that the Pension Fund has spent more than its approved budget.

2.3 Further detail on the draft outturn position is found in Appendix 1.

3.0 Corporate Priorities and Joint Working:

3.1 There is a specific objective in the Corporate Plan that the Council will have excellent financial management arrangements to ensure that it continues to keep a balanced and sustainable budget and is living within its means. In addition, the Council continues to pursue a range of measures, which will enable effective and successful management of its finances over the medium to long term.

3.2 Within the next 20 years, the investment strategy of the Pension Fund is targeted with achieving a 100% funded position in order to ensure that the scheme remains affordable and sustainable in the future.

4.0 Key Issues:

4.1 On 6 March 2018 (Min Ref 03/18), the Pension Fund Committee approved the 2017/18 Pension Fund Budget. It is vital to the economic wellbeing of the Pension Fund that its financial resources are managed effectively and that net income is delivered in line with the budget, as any overspends or under-achievements of income could result in a reduction in the net contribution to the Pension Fund.

4.2 This report forms part of the financial governance and stewardship framework, which ensures that the financial position of the Pension Fund is acknowledged, understood and quantified on a regular basis. It provides assurance to the Corporate Management Team and the Committee/Board that resources are being managed effectively and it allows corrective action to be taken, where applicable.

4.3 At Quarter 4, the Pension Fund is showing a draft under-achievement of net income of £991k (14.7%). This year has seen greater fluctuations from the 5-year average on which the budget is based. Predicting individual choice is difficult and has a significant impact and this is reflected in the variance between budget and actual for, pension, lump sums and transfer payments.

5.0 Exempt and/or confidential information:

5.1 None.

6.0	**Implications :**
6.1 Service Users, Patients and Communities:	None arising from this report.
6.2 Human Resources and Organisational Development:	None arising from this report.
6.3 Equality, Diversity and Human Rights:	None arising from this report.
6.4 Legal:	None arising from this report.
6.5 Finance:	The Pension Fund Investment Strategy, approved in 2015/16, is currently under review with KPMG the Pension Fund's investment consultants. The aim of the strategy is to ensure that the Pension Fund is 100% funded within the next 20 years. It is vital that the Pension Fund continues to receive a surplus of income over expenditure as it is a component of the strategy to become fully funded and keep the employers contributions at a manageable level. . Should the Pension Fund consistently under-achieve its net income budget, employer contributions may need to significantly increase in order to meet any shortfall. The success of the investment strategy, the performance of the fund managers and the cost of future liabilities, all of which are considered as part of the triennial fund valuations, are also factors that could have an effect on employer contributions.
6.6 Assets and Property:	None arising from this report.
6.7 ICT and new technologies:	None arising from this report.

6.8 Environmental:	None arising from this report.	
6.9 Risk Management:	There are numerous risks involved in the delivery of the Pension Fund and awareness of these risks is critical to successful financial management. From a financial perspective, risks are an integral part of planning for the future, as assumptions and estimates are involved. These assumptions can be affected by many internal and external factors, such as supply and demand, which could have an adverse impact. The main financial risks for the Pension Fund are: • That the Fund's investments fail to deliver returns in line with those required to meet the valuation of long-term liabilities; • That bond yields fall, leading to a rise in value placed on liabilities; • That employers leave the scheme or the scheme closes to new members, which could be attributed to factors such as cost, liquidation or bankruptcy; • That a failure to recover unfunded payments from employers occurs, potentially leading to other employers having to increase their employer contributions to subsidise; • That a global stock market failure occurs; • That active fund managers under-perform against expectations.	
6.10 Policy and Delegated Authority:	The Pension Fund Committee has been delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013. The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pension Regulator.	
6.11 Previously considered by:	*n/a*	*n/a*

Contact Details:

Jacqueline Johnson, Senior Assistant Accountant, 01595 744625
Jacqueline.johnson@shetland.gov.uk

Appendices:

Appendix 1 - Draft Outturn Position for 2017/18

Background Documents:

Pension Fund Budget Proposals 2017/18, Pension Fund Committee/Pension Board, 7 December 2016 http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=20199

F-030 Appendix 1

Pension Fund Committee / Pension Board

1. Revenue Outturn Position 2018/19 (Quarter 4)

Budget v Projected Outturn variance at Q3 (Adv) / Pos	Pension Fund	Revised Annual Budget	Draft Annual Outturn	Budget v Draft Outturn variance at Q4 (Adv) / Pos
£000		£000	£000	£000
6	Employee Costs	264	255	9
(118)	Operating Costs	145	254	(109)
(26)	Investment Expenses	1,573	1,564	9
204	Benefits Payable	10,557	10,803	(246)
(440)	Transfers Out	300	493	(193)
(514)	Lump Sums	2,003	2,801	(798)
(334)	AVC Out	480	886	(406)
(1,222)	**Total Expenditure**	**15,322**	**17,056**	**(1,734)**
122	Contributions Received	(17,569)	(17,755)	186
206	Investment Income	(3,394)	(3,612)	218
177	Transfers In	(300)	(491)	191
148	AVC In	(800)	(948)	148
653	**Total Income**	**(22,063)**	**(22,806)**	**743**
(569)	**Net Income**	**(6,741)**	**(5,750)**	**(991)**

An explanation of the significant variances to budget for the Pension Fund at Quarter 4 is set out below. This is a draft outturn and some of the outturns, such as investment income are still estimates at this stage.

1.1 Operating Costs – overspend of £109k (75.2%)

This overspend is related to tax on lifetime allowances, which occurs when retirees have accumulated more in their pension pot than is allowed by HMRC. Provision exists for the Pension Fund to pay the tax due with an adjustment being made to retirees retirement benefits.

1.2 Transfers Out – overspend of £193k (64.3%)

The value of transfers out varies, due to a number of factors including length of service and salary. The budget is based on an average over 5 years and doesn’t take account of any large single transfers out. The draft outturn is made up of 18 transfers out at an average of £27k each, where the budget was based on 10 transfers out at a cost of £30k each.

1.3 Lump Sums – overspend of £798k (39.8%)

The value of lump sums payable to retirees varies greatly depending on a number of factors including length of service, salary guaranteed lump sum entitlement, commutation of pension to lump sum, etc. The position represents 119 retirees, analysed as follows:

- 64 normal retirements (£891k);
- 16 late retirements (over 65) (£257k);
- 16 ill-health retirements (£498k);
- 8 flexible / phased retirement lump sums (£199k)
- 4 redundancy/efficiency retirements (£131k).

A flexible or phased retirement is where the employee accesses their retirement benefits and is still employed on reduced hours and/or reduced grade.

Death-in-Service benefit lump sums are paid out at the rate of three times salary. Eleven payments in this regard have been made amounting to £464k.

The amount of lump sums as stated above has been greater this year than the 5-year average budgeted for.

1.4 Additional Voluntary Contribution (AVC) Out – overspend of £406k (84.6%)

The budget is based on an average over 5 years, with an assumption that most people receiving AVC would only take a proportion as a lump sum. The experience this year is that many of the scheme members have taken all or most of the AVC as a lump sum.

1.5 Contributions Received – over-achievement of £186k (1.1%)

This over-achievement relates to strain income which is received by the Pension Fund when someone in one of the admitted bodies retires early, and the admitted body has to pay for the cost of the early retirement.

1.6 Investment Income – over-achievement of £218k (6.4%)

The outturn figure was calculated based on the year to date income and extrapolated for the remaining quarter of 2018/19. Investments have produced higher than anticipated returns due to property investments, which have performed well this year.

1.7 Transfers in – over-achievement of £191k (63.7%)

This is due to more, higher value transfers being received than budgeted. Income from transfers into the Pension Fund is based on the value of a new employee’s previous pension benefits; transfers in from other local authority Pension Funds are often higher value than those from private Pension Funds.

The budget is based on a five-year rolling average of 15 transfers at £20k each. The draft outturn has exceeded the budget, consisting of 19 transfers in at an average of £29k.

1.8 Additional Voluntary Contribution (AVC) in – over-achievement of £148k (18.5%)

This budget is based on an average over 5 years. It is difficult to predict as the value of AVCs received is dependent on how many scheme members have an AVC fund, how much they pay into their AVC fund and for how long. Twenty three AVC's have been received, which has exceeded the budget, and all but three have been used either fully or partially for a lump sum.

Shetland Islands Council

Agenda Item

2

Meeting(s):	**Pension Fund Committee** **Pension Board**	**9 May 2019** **9 May 2019**
Report Title:	**Pension Fund Management Annual Investment Review 2018/19**	
Reference Number:	**F-034-F**	
Author / Job Title:	**Executive Manager - Finance**	

1.0 Decisions / Action required:

1.1 That the Pension Fund Committee and Pension Board NOTE:

- the performance of BlackRock which was close to the benchmark in 2018/19;
- the underperformance of the benchmark and target by KBI in 2018/19;
- the outperformance of the fixed benchmark by Newton in 2018/19;
- the outperformance of the benchmark but underperformance of the target by Schroders in 2018/19;
- the underperformance of the fixed benchmark by M&G in 2018/19.

2.0 High Level Summary:

2.1 The purpose of this report is to inform the Pension Fund Committee and Pension Board on the position and performance of the Pension Fund's external investments, with fund managers for the financial year 2018/19.

2.2 The Pension Fund's investments increased in value by £38 million over the 2018/19 financial year and now have an overall value at the end of March 2019 of £497 million. The investment return for the Pension Fund in 2018/19 was 8.1%. See additional information in Appendix 1.

2.3 Over the 2018/19 financial year BlackRock were close to their benchmark aim, KBI Global Investors and M&G underperformed their benchmarks while Schroders and Newton outperformed their benchmarks.

2.4 The conclusion of the annual review is that Fund Manager performance has been mixed individually but in absolute terms 0.7% below the overall benchmark. Performance of the investments, was dominated by the volatility seen in the equity markets which can happen over short time periods, so there is no immediate reason to investigate further the Pension Fund making changes.

2.5 A review of the Pension Fund Investment Strategy is currently underway with

	KPMG the Pension Fund's investment consultants. The findings and recommendations from the review will be reported at a later date.
3.0	**Corporate Priorities and Joint Working:**
3.1	This report links to the Council's corporate priorities, defined in its Corporate Plan, specifically in relation to assisting the Council in ensuring the financial resources are managed.
4.0	**Key Issues:**
4.1	This report is an annual review of how the markets and fund managers have performed. All of the Pension Fund's investments are invested for the long term in line with the 2014 Pension Fund investment strategy.
5.0	**Exempt and/or confidential information:**
5.1	None
6.0	**Implications :**

6.1 Service Users, Patients and Communities:	The monitoring of fund manager performance is a means of providing reassurance to members and employers that the fund is being managed appropriately for the long term sustainability objectives and to ensure that monies will be available to fund future pension benefits.
6.2 Human Resources and Organisational Development:	None
6.3 Equality, Diversity and Human Rights:	None
6.4 Legal:	As required by The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, where investment managers have been appointed their performance must be kept under review.
6.5 Finance:	The long term investments and their performance are important to the Pension Fund and the achievements of its outcomes and objectives. It is recognised that the actual investment performance each year will be different to what is expected or required however over the long term this will be monitored and reviewed to ensure that the Pension Fund is working towards meeting its long term objectives. It is not likely that the Pension Fund can expect a positive investment return from its investments every year but having

	robust governance and monitoring in place, alongside a diversified investment strategy, mitigates the financial risks and enables the Pension Fund to take action at appropriate times to address poor performance by the fund managers. This report is part of that governance and monitoring framework.
6.6 **Assets and Property:**	Long term investments are assets of the Pension Fund and represent money given to fund managers to manage on its behalf for long term benefit. The Pension Fund relies upon each fund manager's fiduciary duty and to buy and sell appropriate assets in accordance with the mandate awarded to them and to report regularly on the value and performance of the fund in which Pension Fund money is invested. The value of long term investments under these mandates can go down as well as up.
6.7 **ICT and new technologies:**	None
6.8 **Environmental:**	Whilst the fund managers have delegated powers for the acquisition and realisation of investments, fund managers are expected as part of their investment process to consider all factors, including the social, environmental and ethical policies of companies in which they may invest, to the extent that these may materially affect the long term prospects of such companies. The fund managers will also be expected to enter into dialogue with companies in which they invest, in relation to the pursuance of socially responsible business practices, and report on these activities. Corporate Governance is a key responsibility for institutional shareholders and as a matter of principle the Pension Fund will seek to exercise all of its voting rights in respect of its shareholdings. It is recognised however that in practical terms this may not always be possible for overseas holdings. However for UK stocks all voting rights will be exercised in a positive fashion, i.e. no abstentions. The fund managers, who will act in accordance with this policy, will exercise voting. All of the Pension fund managers have signed up to the United Nations Principles on Responsible Investment. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and therefore must be given appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty. The Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices, and so better align their objectives with those of society at large.
6.9 **Risk Management:**	All investments carry risk. Risks, such as market risk are mitigated and actively managed through diversification of fund

	managers, asset classes, markets, size of holdings and through performance monitoring against benchmarks.	
6.10 Policy and Delegated Authority:	The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administrating authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013. The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator. The Pension Board will determine the areas they wish to consider.	
6.11 Previously considered by:	None	

Contact Details:

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Telephone: 01595 744616
E-mail: colin.bain@shetland.gov.uk

Appendices:

Appendix 1 - Pension Fund Management Annual Investment Review 2018/19

Background Documents:

None

Appendix 1

Pension Fund Management Annual Investment Review 2018/19

1.0 Background

1.1 This report forms part of the Pension Fund's governance arrangements where the Pension Fund Committee and Pension Board will receive an annual investment report for 2018/19 on the external investments.

1.2 This report also fulfils a requirement under The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 for the Council, as administering authority for the Pension Fund, to keep investment Managers' performance under review.

1.3 This report concentrates on the financial year 2018/19. The report looks at the performance of the Pension fund managers, the overall investment performance relative to the markets, the physical movement of funds, any changes from the investment strategy, and any other relevant issues relating to the investments over the period.

1.4 The current investment strategy was approved by the Council on 26 March 2014 (Min. Ref. 17/14). The strategy's focus is on achieving a 100% funding level over a period of time, which is before the Pension Fund's contributions equal benefits payable.

1.5 The reorganisation of the Pension Fund's investments occurred in November and December 2014 with performance monitoring of the new strategy commencing on the 1st January 2015. The new investment strategy resulted in three new mandates being awarded, a new Equity mandate to Kleinwort Benson (now KBI Global Investors), a new Alternative Credit mandate to M&G and a new Diversified Growth Fund mandate to Newton.

1.6 KPMG, the Pension Fund's investment consultants, are currently conducting an interim investment strategy review of the Pension Fund. This investment strategy review follows on from the actuarial review which the Pension Fund's actuaries conducted last year. The investment strategy review is in line with the Pension Fund's long term monitoring, to review the investments after an actuarial review to ensure the Pension Fund's investments are performing as required and the Pension Fund is heading towards a long term fully funded position.

2.0 Investment Position and Market Performance

2.1 The Pension Fund has five fund managers, with total investments under management at the end of March 2019 of £497 million. Their specific mandates and current percentage allocations are as follows:

Manager	Fund	% of Assets
BlackRock	Equity	42
KBI Global Investors	Equity	21
Newton	Diversified Growth	16
Schroders	Property	13
M&G	Alternative Credit	8

2.2 The initial investment allocations were set when the investment strategy was put in place at the end of December 2014. The percentage allocations at 2.1 are a reflection of the market movements, investment management by fund managers and cash additions since December 2014. These movements have altered the initial investment percentages. No movement of funds between fund managers occurred during 2018/19. As KPMG are conducting an interim investment strategy review during 2019/20 there will not be any movement of funds between fund managers, unless from any changes required from the outcome of the investment strategy review.

2.3 The external investments of the Pension Fund are co-ordinated by the Council's Treasury function. The Council's investments are also co-ordinated by the Council's Treasury function. This approach provides the opportunity to share experience and benefit from knowledge in a specialist subject area built up over a number of years.

2.4 On an annual basis each fund manager makes available their internal controls report. These reports are produced by their respective external auditors, and review all aspects of the fund manager's operating controls, with any concerns and weaknesses reported. The reports are reviewed by the Treasury Section within the Finance Service annually, with any concerns or issues identified that may impact on the Pension Fund reported accordingly. No issues were found that required to be reported.

2.5 The Council's Pension Fund is in a growth phase where income from Employer and Employee contributions are projected to exceed benefits paid to pensioners, and is expected to continue for the next 8 years. Consequently, a long-term investment strategy is appropriate. This allows us to have a higher percentage of equity investments, which in itself produces a greater volatility of returns over the short to medium term, i.e. 1-3 years, but is less evident over longer periods. Over the long term this investment policy has proved beneficial with the Pension Fund up 45% over the last 5 years.

2.6 The Managers, type of mandate and market value are listed below:

Manager	Market Value £ million 2019	2018
BlackRock	211	193
KBI Global Investors	103	96
Newton	81	75
Schroders	63	56
M&G	39	39
Total	497	459

2.7 This report at section 3 presents a review and comparison of the performance of each fund manager in turn and a comparison of their performance in 2018/19 against the relevant market's performance where they were asked to invest, and if appropriate, also against any additional out performance target they were asked to achieve.

2.8 Due to the nature of the investments the fund managers are investing into, a long term investment view is appropriate, generally a five year period. The report therefore looks not only at each manager's performance over 2018/19 but also at their performance over a five year period, or from inception of the mandate if that is shorter.

2.9 This report concentrates on the fund manager's performance relative to the markets but there is a need to consider the effect of any cash withdrawals or injections to the funds and the performance of the markets themselves. These influences can easily alter the absolute fund value.

2.10 The following table shows the effect on the fund due to withdrawals/additions, the investment return over the financial year to March 2019 and as a comparison the previous financial year.

	Pension Fund £ million 2018/19	2017/18
Opening Value	459	450
Additions/(Withdrawals)	2	3
Investment Return	36	6
Closing Value	497	459

2.11 During 2018/19 the overall value of the Pension Fund's investments increased by £38 million.

2.12 There was a positive investment return over the 2018/19 financial year of £36 million. The main contributing asset class to the investment return was equities, specifically the Global ex UK passive equity fund invested with BlackRock which returned 12.3% during 2018/19.

2.13 The £2 million of additions during 2018/19 is in main due to the difference between the employer and employee contributions (Council and admitted bodies) versus the pension payments during the year.

2.14 The 2018/19 market performance by asset class is set out below:

		%
Equities:	UK	6.4
	North America	16.8
	Europe (Ex UK)	2.2
	Japan	-0.8
	Pacific	12.6
	Emerging Markets	-0.3
Bonds:	UK Index Linked Gilts	5.7
	UK Corporate	3.7
Property		4.8
Cash		0.7

2.15 The best performing sector in 2018/19 was North America equities with a return of 16.8%, followed by the Pacific region at 12.6%. Equity markets overall produced very mixed returns with Japan and emerging markets having negative returns over the year. Bonds had a quiet year in 2017/18 but the volatility in equity markets saw investments move to bonds, and index linked bonds benefitted with a 5.7% return for 2018/19. Property did not reach the double digit figures seen in 2017/18, but still produced a good return of 4.8% in 2018/19. Cash returns are still low as UK interest rates remain low.

2.16 The main constituent of a fund's performance is the market return, i.e. where the fund is invested. A number of fund managers are asked to outperform the market return, a UK equity scenario in 2018/19 where a fund manager is asked to outperform the UK market by 2% would equate to an 8.4% target return.

2.17 In some instances fund managers are investing in many different markets and in this situation no market benchmark is appropriate, so a cash plus benchmark is used. This is the situation for Newton and M&G where they have fixed benchmarks that are not related to investment markets, e.g. Newton's benchmark is 1 month LIBOR (Cash) + 4%.

3.0 Fund Manager Review

3.1 This section of the report takes each mandate in turn and discusses manager performance.

3.2 A fund manager's performance is measured against a specific fund benchmark, which is made up of market indices of the countries where they invest.

3.3 Some fund managers are passive managers (in general they match their investment profile to the indices (benchmark) they are compared to, with the objective being to achieve investment returns that are the same as the index); while other fund managers are active managers (they make choices and investment decisions that move their investment profile away from a particular index and look to exceed the index by taking account of various investment decision making factors, for example future dividend or growth prospects. Active management will often involve research activities and involve a higher level of risk – which incorporates manager risk).

3.4 With an active investment the Pension Fund can set a target return, this is a level of outperformance above the benchmark that is seen as achievable with a low level of measured risk on a given mandate. The Manager will seek to produce investment returns in order to achieve the stated target. Performance at or above target is desirable but any returns above the benchmark will add value to the fund above the market return that was achieved for the period.

BlackRock

3.5 BlackRock was initially a large US fund management business but over the past few years they have acquired Merrill Lynch and BGI, to become one of the largest global fund managers.

3.6 BlackRock have managed a passive equity mandate on behalf of the Pension Fund since December 2009. BlackRock's passive mandate was reorganised in 2014 as part of the new Pension Fund investment strategy with performance monitoring starting in January 2015.

3.7 BlackRock's benchmark until December 2014 was 45% UK equities, 45% overseas equities and 10% bonds. After the Pension Fund reorganisation BlackRock's fund now has a benchmark of 47% UK equities and 53% global ex UK equities.

3.8 The fund is passively invested, removing the Manager risk, therefore the benchmark and the target are the same, i.e. one aim the index return. For performance comparison purposes the fund return is only compared against the index return.

3.9 The following table sets out in summary the performance of BlackRock versus the benchmark return for 2018/19 and also on a cumulative basis over a five-year investment period.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2018/19	9.9	0.4	9.9

Five years 14/15 to 18/19	56.7	0.7	9.4
The performance v benchmark figure gives the percentage that the fund has out or underperformed the benchmark.			

3.10 BlackRock returned 9.9% in 2018/19, which was 0.4% above the benchmark return. This shows that the fund is close to the returns of the markets the fund invests into. The 0.4% difference from the benchmark is mainly due to a tax legislation change in Japan allowing dividend tax reclaims for certain investment funds.

3.11 BlackRock's mandate is split 53%:47% between Global and UK equities. Both investment sectors produced positive returns with global equities returning 12.3%, and UK equities returning 6.4%. This is a passive investment that tracks the market return, so the overall return of 9.9% is a reflection of the general market return.

3.12 On a cumulative basis over the five year rolling monitoring period the fund is 0.7% above the benchmark return, which is close to the fund's investment aim of replicating the performance of the markets. During this five year period the fund has increased in value by 56.7%, which equates to a return of 9.4% per annum.

KBI Global Investors

3.13 Kleinwort Benson (now KBI Global Investors) was awarded a £68 million global equity mandate in November 2014 as part of the Pension Fund's investment strategy review. They received the funds in December 2014 with performance monitoring commencing January 2015.

3.14 KBI Global Investors was originally formed in 1980. Their headquarters is in Dublin, Ireland. They were founded in 1980 and were part of the Kleinwort Benson Group. During 2016 the Kleinwort Benson Group sold their Dublin investment company to Amundi, a large European fund manager. Amundi have left KBI Global Investors alone to continue to operate their business.

3.15 KBI invests via a set systematic investment process, which uses a strategy that financially robust, higher dividend paying stocks will outperform over the long term. It is an actively managed equity mandate.

3.16 The performance target for this fund is to beat its benchmark by 3.0% per annum.

3.17 The following table sets out in summary the performance of KBI versus the benchmark and the performance target in 2018/19 and on a cumulative basis since inception of the mandate in January 2015.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Performance v Target (%)	Annualised Fund Return (%)
2018/19	6.6	-5.4	-8.4	6.6
From inception Jan 15 – Mar 19	49.1	-7.1	-18.0	9.9

The performance v benchmark figure gives the percentage that the fund has out or underperformed the benchmark return (market indices).

The performance v target figure gives the percentage that the fund has out or underperformed the set target.

3.18 KBI returned 6.6% in 2018/19 which was 5.4% below the benchmark and 8.4% below the target. These are poor figures from KBI for 2018/19 as compared to the market return. KBI continue to find the current market sentiment towards certain growth stock sectors frustrating, which they spoke about when they presented to the Pension Meeting in March 2019, as it is detrimental to their performance.

3.19 On a cumulative basis since inception KBI are below the benchmark and the target, but the fund has increased in value by 49.1%, which equates to a return of 9.9% per annum.

3.20 KBI is under benchmark over four and a quarter years. After a poor initial first quarter investment return to March 2015 they were making progress to get back to the benchmark return. Their performance was flat in 2016/17 and 2017/18 but their underperformance in 2018/19 has seen KBI fall well below the benchmark return. This is an active equity fund based on dividend returning shares with a bias towards value shares in the market. The issue is that the current market is being driven by large growth focused companies, i.e. large technology companies that do pay dividends, and are therefore not in KBI's portfolio. KBI are confident that the current growth focus of the equity markets cannot continue and will shift back to more sensible value based investing which will benefit their investment strategy.

Newton

3.21 Newton was awarded a £68 million global equity mandate in November 2014 as part of the Pension Fund's investment strategy review. They received the funds in December 2014 with performance monitoring commencing January 2015.

3.22 Newton is a wholly owned but autonomous subsidiary of Bank of New York Mellon. Bank of New York Mellon has various investment businesses throughout the world but generally leave the companies alone to continue with their specialist services.

3.23 The Pension Fund mandate with Newton is a diversified growth fund mandate and is invested in Newton's Real Return Fund, which is an unconstrained multi asset strategy seeking to return 1 month LIBOR (cash) +4% per annum. The agreed benchmark is a cash plus benchmark, which aims at a constant positive return every year. As it is a fixed constant positive benchmark, the benchmark and target are the same so performance is only compared to the benchmark.

3.24 The Real Return Fund uses a wide range of different investments which they categorise into return seeking assets (infrastructure, equities, debt), stabilising assets (commodities, index-linked bonds, government debt) and hedging positions to provide downside protection (currency, equity and bond options).

3.25 The following table sets out in summary the performance of Newton versus the fixed benchmark in 2018/19 and on a cumulative basis since inception of the mandate in January 2015.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2018/19	7.6	2.9	7.6
From inception Jan 15 – Mar 19	13.6	-5.8	3.1
The performance v benchmark figure gives the percentage that the fund has out or underperformed the fixed benchmark return.			

3.26 Newton returned 7.6% in 2018/19, which was 2.9% above the benchmark. Equities were the main driver of the return but alternatives, corporate bonds and emerging market debt all contributed to the outperformance.

3.27 On a cumulative basis since inception in January 2015 Newton are still 5.8% below the benchmark. Newton continues to take a cautious outlook on the global economic situation. Their strategy remains to preserve the capital value of the fund while trying to focus on harnessing return from various different resources available to them.

3.28 The unconstrained nature of the investment gives flexibility to Newton to swiftly implement any investment decisions. Newton are concerned about the potential risk of increased economic uncertainty but they try to balance their caution with the objective to achieve the performance return target when opportunities arise which they say are quite frequent in these volatile times.

Schroders

3.29 Schroders were awarded a £20 million Property Mandate in March 2007 with the first investments commencing in July 2007.

3.30 Schroders invests into property via a fund of funds approach where they invest in various different property funds to spread investment risk. Currently Schroders are investing in 16 different property funds. The fund is mainly invested in the UK with one small fund holding in Europe.

3.31 The benchmark for this fund is based on a 100% UK property investment. The fund manager does however have the scope to invest up to a maximum of 30% of the fund in overseas property if attractive investment opportunities exist. The performance target for this fund is to beat a specific benchmark by 1.0% per annum.

3.32 Schroders have used the flexibility in the mandate to invest in their European property fund. This investment initially outperformed, but then went through a number of years where it was a drag on performance due to the general European economic climate. This investment is now currently 0.6% of the overall mandate.

3.33 As part of the Pension Fund strategy review in 2014 Schroders mandate was increased from 10% to 12% of the Pension Fund's assets. Schroders invested the additional funds in UK property when good opportunities arose and achieved full investment in 2016/17.

3.34 The following table sets out in summary the performance of Schroders versus the benchmark and the performance target in 2018/19 and on a cumulative basis over a five-year investment period.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Performance v Target (%)	Annualised Fund Return (%)
2018/19	5.1	0.3	-0.7	5.1
Five years 14/15 to 18/19	54.5	0.1	-4.8	9.1

The performance v benchmark figure gives the percentage that the fund has out or underperformed the benchmark return (market indices).

The performance v target figure gives the percentage that the fund has out or underperformed the set target.

3.35 The Property Fund with Schroders in 2018/19 increased in value by 5.1%, which was 0.3% above the benchmark return but 0.7% below the target. The industrial sector, regional offices, industrials and alternatives performed well while the retail sector and central London offices struggled.

3.36 On a cumulative basis since inception Schroders are just above the benchmark by 0.1% although below the target, but the fund has increased in value by 54.5%, which equates to a return of 9.1% per annum.

3.37 During 2018/19 Schroders made an investment into a real estate debt fund which the Pension Fund Committee approved, this investment is now about £1.9 million in value and around 3.1% of the overall Schroders fund. Over the year Schroders have also deliberately built up a cash position to invest into new strategies to take advantage of opportunities that may arise. At the end of the financial year Schroders had £4.3 million in cash which is about 6.8% of the overall fund value. Schroders are currently interested in investing in areas such as regional offices, real estate debt and retirement villages.

M&G

3.38 M&G was awarded a £34 million global equity mandate in November 2014 as part of the Pension Fund's investment strategy review. They received the funds in November 2014 with performance monitoring commencing January 2015.

3.39 M&G investment management was a wholly owned subsidiary of the listed financial services group, Prudential. The Prudential group has now split into two separate companies, and M&G is now called M&G Prudential and they cover the UK based insurance and asset management operations of the original Prudential group. M&G have stated that this will have minimal effect on their business, and KPMG the Pension Fund's investment consultants have no immediate concerns with this announcement as M&G has always retained a high degree of autonomy from the parent company.

3.40 The Pension Fund mandate with M&G is an alternative credit mandate invested in M&G's Alpha Opportunities Fund. This fund is an actively managed multi-asset fund that will move in and out of different credit markets to generate returns. The fund can invest in investment grade bonds, loans, high yield bonds and asset backed securities.

3.41 The fund's performance benchmark is 1 month LIBOR (cash) plus 3-5%. The agreed benchmark is a cash plus benchmark, which aims at a constant positive return every year, which is independent of the investment classes that the fund invests into. As it is a fixed constant positive benchmark, the benchmark and target is the same so performance is only compared to the benchmark.

3.42 The following table sets out in summary the performance of M&G versus the benchmark in 2018/19 and on a cumulative basis since inception of the mandate in January 2015.

Fund Performance versus Benchmark

	Fund Return (%)	Performance v Benchmark (%)	Annualised Fund Return (%)
2018/19	0.9	-2.7	0.9
From inception Jan 15 – Mar 19	11.8	-3.6	2.7
The performance v benchmark figure gives the percentage that the fund has out or underperformed the fixed benchmark return.			

3.43 M&G returned 0.9% in 2018/19, which was below the benchmark. This return is a combination of the various sectors that M&G invest into. The main returns coming from industrial and financial bond holdings and general loan holdings.

3.44 On a cumulative basis since inception in January 2015 M&G are 3.6% below the benchmark. The fund has since inception increased in value by 11.8% which equates to a return of 2.7% per annum. M&G have recently been taking some profits from bonds as the current market volatility they believe will present new opportunities in the bond market.

4.0 Investment Governance

4.1 During 2018/19 the Pension Fund Committee and Pension Board received quarterly investment performance reports covering all of the Pension Fund's investment managers. This reporting framework incorporates the statutory Annual Review and Mid Year review.

4.2 The Pension Fund Committee and Pension Board on reviewing the quarterly report can if they believe it would be beneficial request a presentation from a fund manager, to find out more about a specific mandate or question that manager about their performance. During 2018/19 fund managers Newton, KBI Global Investors and BlackRock along with Hymans Robertson the scheme's actuary gave presentations to the Pension Fund Committee and Pension Board.

5.0 Conclusions

5.1 BlackRock were close to their aim of equalling the equity benchmark return during 2018/19. Over the five year period BlackRock are close to the equity benchmark return.

5.2 KBI underperformed the equity benchmark and target during 2018/19. Over the four and a quarter years of their mandate KBI are under the equity benchmark.

5.3 Newton outperformed the fixed benchmark during 2018/19. Over the four and a quarter years of their mandate Newton are under the fixed benchmark.

5.4 Schroders outperformed the UK property benchmark during 2018/19 but did not achieve the target. Over the five year period Schroders are just above the property benchmark.

5.5 M&G underperformed their fixed benchmark during 2018/19. Over the four and a quarter years of their mandate M&G are under the fixed benchmark.

The bond and property investment markets produced positive returns in 2018/19 while the equity markets had mixed results, with America and the Pacific region equity markets producing the best returns. This along with the fund managers' management of the funds helped to contribute £36 million in investment returns to the Pension Fund over the 2018/19 financial year. The Pension Fund ended the financial year with a valuation of £497 million.