Shetland Islands Council

Executive Manager: Jan-Robert Riise
Director of Corporate Services: Christine Ferguson

Governance & Law
Corporate Services Department
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If calling please ask for
Louise Adamson
Direct Dial: 01595 744555
Email: louise.adamson@shetland.gov.uk

Date: 29 November 2018

Dear Sir/Madam

You are invited to the following meeting:

Special Pension Fund Committee / Pension Board
Council Chamber, Town Hall, Lerwick
Wednesday 5 December 2018 at 10 a.m.

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 meetings held on (i) 28 August 2018, (ii) 19 September 2018, and (iii) 8 October 2018 enclosed.

ITEMS

1.	Membership of the Pension Fund Committee *GL-20*
2.	Pension Fund – 2018/19 Mid-Year Performance Review *F-085*
3.	Management Accounts for Pension Fund Committee – Projected Outturn at Quarter 2 *F-080*
4.	Scottish LGPS Restructure Review – Consultation Response *F-088*

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**: David Marsh, Unison Alan Goudie, Unite Robert Williamson, GMB Austin Taylor, Unison *Substitutes*: *C Wiseman, Unison* Joint Secretary C Wiseman, Unison

Shetland
Islands Council

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MINUTES

A&B – Public

Pension Fund Committee	Pension Board
Council Chamber, Town Hall, Lerwick	**Council Chamber, Town Hall, Lerwick**
Tuesday 28 August 2018 at 2.00pm	**Tuesday 28 August 2018 at 2.00pm**
Present - Members:	**Present - Members:**
A Cooper, S Coutts	J Fraser, A Goudie
S Leask, E Macdonald	A Westlake, R Williamson
R McGregor, I Scott	C Wiseman
G Smith, T Smith	
R Thomson	
Apologies:	**Apologies:**
C Smith	M Bell
	D Marsh
	J Johnston
	A Taylor

In Attendance:
J Riise, Executive Manager – Governance and Law
H Tait, Team Leader – Accountancy
C Bain, Treasury Accountant
L Adamson, Committee Officer

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
The minutes of the meeting held on 30 April 2018 were confirmed on the motion of Mr Thomson, seconded by Ms Macdonald.

The minutes of the meeting held on 22 May 2018 were confirmed on the motion of Mr Fraser, seconded by Mr Scott.

The minutes of the meeting held on 27 June 2018 were confirmed on the motion of Mr G Smith, seconded by Mr Leask.

13/18 **Membership of the Pension Fund Committee**

The Committee and Board considered a report by the Executive Manager – Governance and Law (GL-16-18-F), which advised of the resignation of Mr Allison Duncan from the Pension Fund Committee, to take effect from 27 June 2018.

The Executive Manager – Governance and Law introduced the report. There being no questions, the Committee and Board noted the report.

Decision:

The Pension Fund Committee and Board NOTED the resignation of Mr Allison Duncan from the Pension Fund Committee.

14/18 **Management Accounts for Pension Fund Committee: 2018/19 - Projected Outturn at Quarter 1**

The Committee and Board considered a report by the Executive Manager - Finance (F-58-18-F), which set out the overall Pension Fund projected financial position as at Quarter 1.

The Team Leader - Accountancy introduced the report. There being no questions, the Committee and Board noted the report.

Decision:

The Pension Fund Committee and Board RESOLVED to review the Management Accounts showing the projected outturn position at Quarter 1.

15/18 **Pension Fund - Quarter to June 2018 Investment Review Report**

The Committee and Board considered a report by the Executive Manager - Finance (F-066-18-F), which presented the investment position and performance of the Pension Fund's external investments, managed on their behalf by Fund Managers, for the quarter to June 2018.

In introducing the report, the Treasury Accountant advised that equities had been the main driver over the quarter, and he provided a summary of the performance of the Fund Managers over the 3-month period. He reported that the most up to date Pension Fund value at the end of July was £497 million.

In response to a question regarding information in the Table at Section 2.2 of the Appendix, the Treasury Accountant provided clarity on the "Benchmark Return" figure compared to the "% Return Compared to Benchmark".

In response to questions, the Treasury Accountant advised on Newton's recent improvement in performance, achieving a return 2.0% above Benchmark during the quarter and that their July performance had also been good.

Decision:

The Committee and Board **NOTED** the outcome of the quarterly review.

16/18 **Pension Fund Risk Register**

The Committee and Board considered a report by the Executive Manager - - Finance (F-070-18-F), which provided up to date information on the risks associated with the Council's Pension Fund.

The Team Leader - Accountancy introduced the report and the Risk Register attached as Appendix 1. There being no questions, 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.

17/18 **Pension Fund Committee and Pension Board Business Programme - 2018/19**

The Committee and Board considered a report by the Executive Manager - Finance (F-52-18-F), which informed of the planned business to be presented to the Committee/Board to 31 March 2019.

The Team Leader – Accountancy introduced the report. In referring to the Business Programme as Appendix A, the Team Leader – Accountancy highlighted the presentation from a Fund Manager at the meeting in December 2018.

During the discussion, a suggestion was made for all five Fund Managers to attend a meeting to present performance on their investments to the Committee/Board, as this would be beneficial to allow for comparisons on all the portfolios. However, the actual benefit to the Committee/Board of hearing from all of the Fund Managers was questioned, as each has a different strategy and approach which impacts on their performance. It was however considered that each of the Fund Managers presenting at separate meetings makes them more accountable to the Committee/Board, allows Members to ask more pertinent questions, and to go into further detail and in depth discussion on investments, markets and performance. During the discussion that followed, the Treasury Accountant suggested that rather than all five Fund Managers presenting to one meeting, that it could be beneficial for the two Equity Fund Managers to present to a meeting, and then the two Diversified Fund Managers to a subsequent meeting, as this would allow for better comparisons to be made. He went on to suggest that different options in terms of the number of Fund Managers presenting at meetings could be looked at for future meetings. The Committee/Board agreed to the suggestion from the Treasury Accountant, that the two Equity Fund Managers be invited to attend the December meeting.

Decision:

The Pension Fund Committee and Board considered its planned business for financial year 1 April 2018 to 31 March 2019 and **RESOLVED** to approve the Business Programme.

The meeting concluded at 2.25pm.

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Chair

Shetland
Islands Council

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MINUTES

A&B – Public

Pension Fund Committee Council Chamber, Town Hall, Lerwick Wednesday 19 September 2018 at 11.50am	**Pension Board Council Chamber, Town Hall, Lerwick Wednesday 19 September 2018 at 11.50am**
Present - Members: A Cooper S Coutts S Leask E Macdonald C Smith G Smith T Smith R Thomson	**Present - Members:** M Bell J Fraser D Marsh A Taylor R Williamson
Apologies: R McGregor I Scott	**Apologies:** A Goudie J Johnston A Westlake
In Attendance: M Sandison, Chief Executive C Ferguson, Director – Corporate Services J Riise, Executive Manager – Governance and Law H Tait, Team Leader - Accountancy K Adam, Solicitor C McCourt, Financial Accountant L Geddes, Committee Officer Also: J Corrigan, Deloitte LLP C Healy, Deloitte LLP P Kenny, Deloitte LLP D Peters, Deloitte LLP *(by telephone)*	

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

Circular
The circular calling the meeting was held as read.

Declarations of Interest
None

18/18 **Annual Audit Report on the 2017/18 Audit - Shetland Islands Council Pension Fund**

The Committee and Board considered a report by the Executive Manager – Finance (F-073-18-F) which set out the findings of the 2017/18 audit as contained in the external auditor's Annual Report.

The Team Leader – Accountancy advised that there had been no changes since the unaudited accounts had been presented in June, and Deloitte LLP had confirmed their unmodified opinion.

Ms Peters outlined the key messages in the report, advising that one significant area of risk – management override of controls - and two areas of audit focus – accuracy of contributions paid to the Fund and valuation of investments – had been considered. The result of the audit control testing had been satisfactory and no material misstatements had been identified, so an unmodified opinion had been issued. Three instances of late payment had been noted, but there were no other issues to report. There was a disclosure deficiency in note 11a of the financial statements, whereby the Schroder Liquidity Fund should be disclosed under “Pooled Investment Vehicle” rather than “Cash Income”, but this was not material and had no effect on the audit opinion. There were a number of technical updates which would have an impact on the scheme in future, so Trustees would have to carry out some work to ensure compliance with the new standards.

The Executive Manager – Governance and Law advised that the Audit Committee had heard the same presentation at its meeting, and had approved the recommendations in the report.

In response to a question relating to the dashboard for significant risk and areas of audit focus, Mr Corrigan advised that items were either classed as satisfactory or not – there were no other categories. This meant that all testing had performed and there were no material errors.

Responding to a question about the late payments, the Team Leader – Accountancy said that the late payments by SADA related to their financial position at the time. This situation had been monitored very closely to ensure that payments were made. She understood that the late payment in relation to SAT had related to staffing in the organisation being unavailable at the time. She went on to say that the issue relating to the Schroder Liquidity Fund would be taken forward in future accounts.

Ms Peters added that although it was common for pension funds to try and classify this under cash income, specialist institutions Deloitte LLP had consulted were comfortable that it should be disclosed as a Pooled Investment Vehicle.

It was commented that there would be a need to discuss interaction with the regulator at future meetings.

The Chair thanked staff from Deloitte LLP, and Council staff for their hard work, and went on to move that the recommendations in the report be approved.

Mr G Smith seconded.

Decision:
The Pension Fund Committee and Pension Board:

- NOTED the findings of the 2017/18 audit as contained in the external auditor's Annual Report

- APPROVED the audited Annual Accounts for 2017/18 for Shetland Islands Council Pension Fund for signature

The meeting concluded at 12.15pm.

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Chair

Shetland
Islands Council

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MINUTES

A&B – Public

<table>
<tr>
<td>Special Pension Fund Committee
Council Chamber, Town Hall, Lerwick
Monday 8 October 2018 at 2pm

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

<u>Apologies:</u>
C Smith G Smith
R Thomson</td>
<td>Special Pension Board
Council Chamber, Town Hall, Lerwick
Monday 8 October 2018 at 2pm

Present - Members:
M Bell D Marsh
A Westlake R Williamson

<u>Apologies:</u>
J Fraser A Goudie</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
K Adam, Solicitor
L Adamson, Committee Officer</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

19/18 **Scottish LGPS Restructure Review**

The Committee and Board considered a report by the Executive Manager – Finance (F-074-F) that sought responses to a consultation on the future of the Scottish Local Government Pension Scheme (SLGPS).

In his introduction, the Treasury Accountant outlined the four options proposed by the Scheme Advisory Board (SAB) that the consultation seeks views on from employee and employer groups for the LGPS as set out in Section 4.5 of the report, for responses by 7 December 2018.

In response to questions, the Treasury Accountant confirmed that a number of other Local Authorities have submitted their responses, and that guidance is sought from the Committee as to their views on the four options presented. The Treasury Accountant said that in his opinion, the full merger which would require a new body to be set up to have responsibility for all Scotland's Pension Funds, investments and administration, would appear to be a drastic option at this time, particularly as all Scottish pension funds are currently in a good funding position. The full merger would remove any local control, and contributions from each Council would be at a level set by the new body.

During the discussion, an overview was provided from a number of the responses submitted on the consultation, which was noted to be wide ranging including support for the status quo through to the full merger position. The Executive Manager – Governance and Law advised that the consultation responses would be made available to the Committee/Board separately, for Members to be aware of the factors raised by other Local Authorities and for comparisons to be made to inform the final response.

In response to a question relating to the success of the pooled pension funds that have been operating in England and Wales over the past 5 years, as referred to in section 4.11 of the report, the Treasury Accountant advised on the controversy in terms of the operation and management of the pooled funds, and on the difficulty to agree a Pension Strategy and on the limited choice of Fund Managers in a pooled situation.

During the discussion comment was made that the main factor relative to the full merger, but also an area of uncertainty at this time, would be the level of employer's contribution. In that regard, it was noted that Shetland could lose out as being a near fully funded Pension Fund compared to those Funds not so well funded.

In response to a question relating to the extent of consultation with the Admitted Bodies, it was noted that the recommendation at 1.2 of the report includes consultation with the Admitted Bodies in order to inform the final response. In that regard, it was suggested that the Team Leader – Expenditure liaise with Mr J Johnston, the Admitted Body representative on the Board, on his proposals to communicate the consultation to the Admitted Bodies network.

During the discussion concern was expressed on a number of areas, including the uncertainty on the costs and benefits from a pooled structure, and it was suggested that the full merger option would be creating another potentially costly quango at a time when the Pension Funds were operating well. It was also questioned whether there would be benefit from all 11 Local Authorities meeting to discuss the four options as presented.

In responding to questions, the Committee and Board were advised on the historic arrangement whereby all 32 Local Authorities in Scotland were linked to the 11 Pension Funds currently in operation.

During the discussion, comment was made on the need to influence Scottish Government in terms of Policy to include wide ranging options in the legislation. The Executive Manager – Governance and Law advised on the forthcoming Leaders meeting where a CoSLA position might be established on the future of the LGPS in Scotland.

During debate, the Leader commented that the discussion today clearly demonstrates the local view, in that there would need to be a strong argument why the status quo should not be retained. He agreed that it would be useful to share the responses from the other Local Authorities with members of the Committee and Board, and proposed that a further meeting of the Committee and Board be arranged before the submission deadline. Support was confirmed for the status quo position, however the importance for feedback from our other Admitted Bodies was also stressed and for their views to be taken into account within the final response.

In referring to the Cabinet Secretary's Foreword to the SAB Consultation document at Appendix A, comment was made on the Government's move towards centralisation, and that the LGPS would appear to be another case in that regard. It was stressed that with any amalgamation of Funds local control would be lost, and that the full merger should be strongly opposed. Reference was also made to the Government's intention as set out in the Foreword, for the SAB to advise on better management of the LGPS to support investment in infrastructure projects.

The Executive Manager – Governance and Law referred to a Brief prepared by the SAB on the Review of the Structure of the SLGPS, which he suggested could also be circulated to Members of the Committee and Board.

The Committee and Board then heard from the Union representatives on the Board. Mr Marsh advised on his views in terms of the options in the consultation, and said that while he shared concerns at the loss of local control, there was also the question of whether the loss of local control was as important as investing to achieve the greater return. He also reported on Unison Scotland's views being very firmly in favour of the full merger, with opportunities for greater net returns from a single Pension Fund, to the benefit of both Members and employers. Mr Williamson advised that he had been involved in meetings to discuss the options, and he found the consultation posed more questions than answers. He also referred to the difficulty to set up a central body to administer a single scheme, and said that a lot of work would be needed before he was convinced to change from the status quo.

Mr Coutts thanked the Board Members for their contributions and moved that the Committee approve the recommendations in the report, with a further meeting of the Committee and Board to be arranged before the submission deadline of 7 December 2018. Mr T Smith seconded.

Decision:

The Pension Fund Committee and Pension Board NOTED the key issues detailed in the report; and

The Pension Fund Committee RESOLVED to grant delegated authority to the Executive Manager – Finance, or his nominee, in consultation with the Chair of the Pension Fund Committee, to conduct further consultation with members of the Committee, Board and Admitted Bodies, in order to inform a final response for presentation to a further meeting of the Pension Fund Committee/Pension Board prior to submission to the Pensions Institute by 7 December 2018.

The meeting concluded at 2.40pm.

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Chair

Shetland Islands Council

Agenda Item

1

Meeting(s):	Special Pension Fund Committee Special Pension Board	5 December 2018 5 December 2018
Report Title:	Membership of the Pension Fund Committee	
Reference Number:	GL-20-18	
Author / Job Title:	Executive Manager – Governance and Law	

1.0 Decisions / Action required:

1.1 That the Pension Fund Committee and Pension Board NOTE the resignation of Mr Cecil Smith from the Pension Fund Committee.

2.0 High Level Summary:

2.1 Mr Cecil Smith has indicated his resignation from the Pension Fund Committee, to take effect from 1 October 2018.

2.2 Membership of the Pension Fund Committee consists of all members of the Council's Policy and Resources Committee appointed by the Council, and therefore under the Council's constitution there is no need to replace the appointment to the Pension Fund Committee at this time.

3.0 Corporate Priorities and Joint Working:

3.1 The recommendation in this report are not linked directly to any of the Corporate Priorities, but supports the Council's responsibilities in terms of ensuring good governance, accountability and partnership working.

4.0 Key Issues:

4.1 The Committee and Board are asked to note the resignation of Mr Cecil Smith from the Pension Fund Committee, from 1 October 2018, and that there is no requirement at this time to replace the appointment.

5.0 Exempt and/or confidential information:

5.1 None.

6.0 Implications:

6.1 Service Users, Patients and Communities:	There are no implications for service users arising directly from this report.

6.2 Human Resources and Organisational Development:	There are no implications for staff arising directly from this report.	
6.3 Equality, Diversity and Human Rights:	There are no equality implications arising directly from this report.	
6.4 Legal:	The legal framework for this report is supported by the Council's Constitution, including the Scheme of Administration and the Standing Orders.	
6.5 Finance:	There are no financial implications arising directly from this report.	
6.6 Assets and Property:	There are no implications for assets and property arising directly from this report.	
6.7 ICT and new technologies:	There are no implications for ICT and ICT systems arising directly from this report.	
6.8 Environmental:	There are no environmental implications arising directly from this report.	
6.9 Risk Management:	There are no risk management implications arising directly from this report.	
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:	N/A	N/A

Contact Details:
Jan Riise, Executive Manager - Governance and Law jan.riise@shetland.gov.uk
26 November 2018

Appendices: None.

Background Documents: None

END

Shetland Islands Council

Agenda Item

2

Meeting(s):	**Pension Fund Committee** **Pension Board**	**5 December 2018** **5 December 2018**
Report Title:	**Pension Fund – 2018/19 Mid Year Performance Review Report**	
Reference Number:	**F-085-F**	
Author / Job Title:	**Jamie Manson, Executive Manager - Finance**	

1.0 Decisions / Action required:

1.1 That the Pension Fund Committee and Pension Board consider the outcome of this Mid Year Performance Review and provide comments accordingly.

2.0 High Level Summary:

2.1 This report will allow the Pension Fund Committee and Board to review the 2018/19 mid year investment position and performance of the Pension Fund's external investments, managed on their behalf by fund managers.

2.2 The Pension Fund's investments increased in value by £44 million over the first six months of the 2018/19 financial year and now have an overall value at the end of September of £503 million.

2.3 Over the first six months of the 2018/19 financial year BlackRock were close to their benchmark aim, while the four active fund managers saw mixed performance results with Newton and Schroders outperforming while KBI and M&G underperformed their respective benchmarks. The combined investment return for the Pension Fund over the six month period was 9.0%. See additional information in Appendix 1.

2.4 The conclusion of the Mid Year review is that Fund Manager performance has been mixed individually but in absolute terms positive overall. Performance of the Fund investments, as indicated by relevant benchmarks, show that investment returns overall could have been better but there is no immediate reason to investigate further the Pension Fund making changes. A review of the overall investment strategy is in progress and the findings and recommendations from that review will be reported at a later date.

2.5 It was envisaged that both BlackRock and KBI Global Investors could attend this meeting and give presentations on their mandates, but due to committee time pressures and the pension consultation these presentations are being held over to the next Pension Fund Committee meeting in March 2019.

3.0 Corporate Priorities and Joint Working:

3.1 One of the reporting requirements of the CIPFA Code of Treasury Management is

	to formally give a Mid Year review report. This report fulfils that requirement, in relation to the Pension Fund Committee and Board while also assisting the Council in ensuring that financial resources are managed.
4.0	**Key Issues:**
4.1	This report is only a six month snapshot of how the markets and fund managers have performed. Over the remainder of the financial year the performance of the Pension Fund's investments could quickly and unpredictably increase or decrease depending on economic and investment circumstances.
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 investment 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	The Pension Fund Committee has delegated authority to

Policy and Delegated Authority:	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:
Colin Bain, Treasury Accountant
Telephone 01595 744616
E-mail colin.bain@shetland.gov.uk

Appendices:
Appendix 1 - 2018/19 Mid Year Performance Review Report

Background Documents:
None

Appendix 1

2018/19 Mid Year Performance Review Report

1.0 Investment Position and Market Performance

1.1 This report complies with the requirements of the CIPFA Code of Practice for Treasury Management in Public Services 2011, in respect of the requirement to report the Mid Year investment position.

1.2 This report concentrates on the six-month period from April to September 2018. The report looks at the performance of the Pension Fund's 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.

1.3 The Pension Fund has five fund managers with total investments under management at the end of September 2018 of £503 million. The funds, type of mandate and market values at the end of September 2018 are as follows:

Manager	Mandate	% of Reserves	Market Value (£m)
BlackRock	Passive Equity	43%	216
KBI Global Investors	Active Equity	21%	109
Newton	Diversified Growth	16%	79
Schroders	Property	12%	60
M&G	Alternative Credit	8%	39

1.4 Individual fund manager performance is detailed later but there is the need to consider the effect of the markets themselves, and of any cash withdrawals or injections into the funds. The following table shows the effect on the overall investments of these factors during the six-month period.

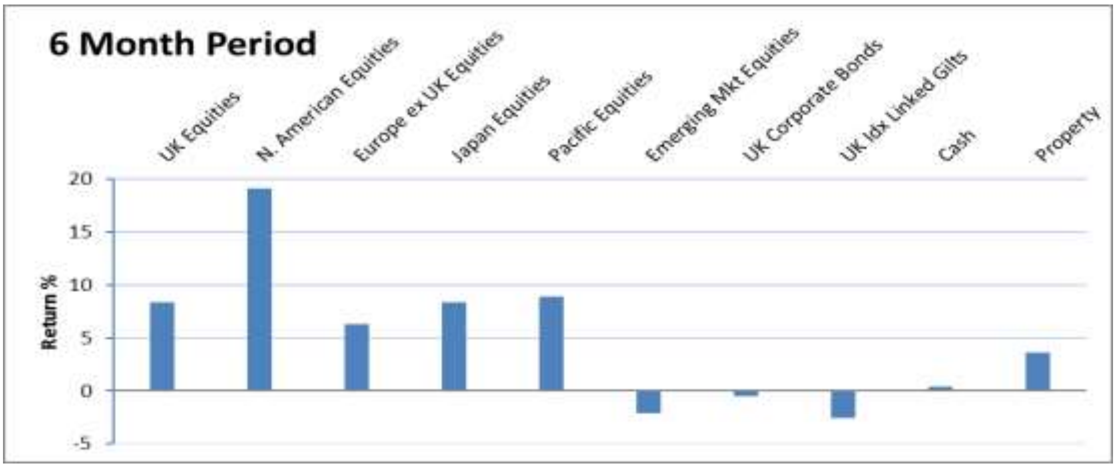
Pension Fund	£ Million
Market value as at 31/03/18	459
Additions / (Withdrawals)	0
Investment Return	44
Market value as at 30/09/18	**503**

1.5 The figures show that the Pension Fund has increased in value by £44 million over the six month period. The increase in investment returns is due to investment returns from various asset classes, with equities being the best returning asset class over the six month period.

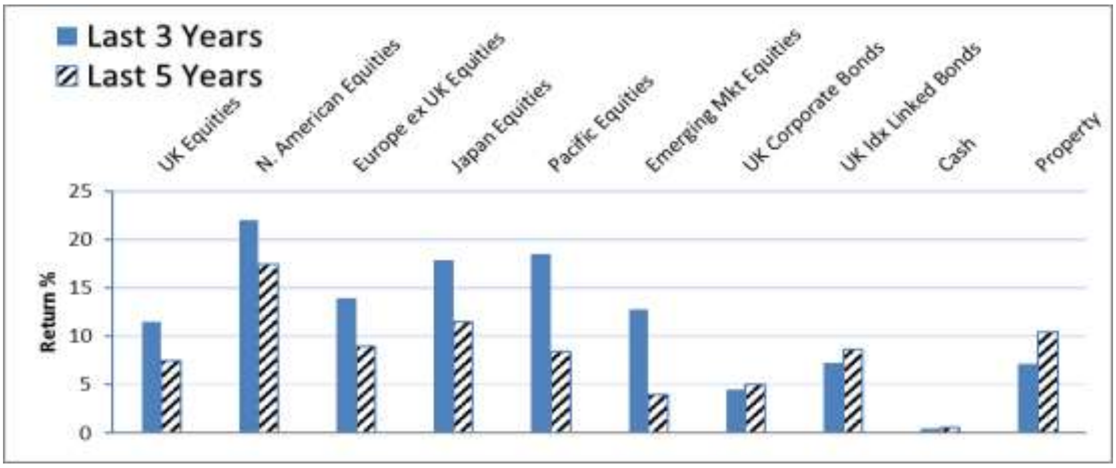
1.6 Over the six month period to September 2018 the US equity markets shrugged off concerns from the ongoing trade wars between the US and China, to see the US market surge ahead based on good company earnings and strong economic data. Tariffs were also imposed by the US on Mexico, European Union and Canada, although the US has now reached agreement with Mexico and Canada. Encouraged by signs of strength in the US economy the US Federal Reserve have increased interest rates twice in this period.

1.7 In the UK Brexit talks continued throughout the period with no clear result, along with a lack of clarity on post Brexit trade but the UK stock market remained in positive territory with sterling weakness boosting overseas profits. The Bank of England did increased interest rates in August 2018 due to low unemployment and concerns about wage pressure. In Europe concerns over the Italian deficit and the new coalition government's planned budget dampened European equities.

1.8 The investment markets performance, over the main asset classes the Pension Fund invests into, over the six-month period looked like this:



1.9 This is only a six month snapshot of how the various investment classes and sectors have performed and it shows how, in the short term, you can have volatility that produces both positive and negative returns. History shows that investments in these asset classes over the long term are usually positive, which is the reason the investment strategy is based on a long term investment horizon. As an example of the differences in market returns over a slightly longer time period the following graph shows the same asset classes returns per annum over the last three and five years.



1.10 The fund manager has negligible influence over the market return but they may be required by the mandate agreement to invest into these markets. The main constituent of a fund's performance is the market return, where the fund is invested. A fund manager with an active mandate is asked to outperform the market return by a certain percentage, whereas a fund manager with a passive mandate is aiming to match the market return.

2.0 Fund Manager Performance

2.1 The Pension Fund invests in various asset classes for the long term, generally five years or more. This report looks at just the performance of the fund managers and the investment return over a six month period.

2.2 The Pension Fund's managers have, over the six month period to end September 2018, performed as follows:

Manager	Mandate	Fund Return	Benchmark Return	% Return Compared to Benchmark
BlackRock	Passive Equity	12.4%	12.2%	0.2%
KBI Global Investors	Active Equity	11.7%	14.9%	-3.2%
Newton	Diversified Growth	4.5%	2.3%	2.2%
Schroders	Property	3.8%	3.6%	0.2%
M&G	Alternative Credit	0.4%	1.8%	-1.4%

2.3 The fund with BlackRock is invested passively in equities, so the fund is aiming to equal the benchmark return. BlackRock was very close to this aim over the six month period.

2.4 The fund with BlackRock is split between UK equities 45% and global ex UK equities 55%. Both of the funds were very close to their respective benchmarks over the six month period with UK equities returning 8.3% and global ex UK investment returning 15.1%. This gave an overall return to the Fund of 12.4% over the six month period, which is a reflection of the mixture of returns from the various markets the fund invests into.

2.5 The fund with KBI Global Investors is in active equities. Their investment strategy is based on income generating shares that pay a steady annual dividend. KBI have over the six month period underperformed the benchmark. Over this period the equity markets have produced mixed returns but the growth areas have predominately been in sectors that do not favour paying dividends. KBI have produced a positive return of 11.7% but have underperformed in a rising market place.

2.6 Newton has a diversified growth fund mandate which invests in various asset classes to spread risk and smooth investment returns. Newton have over the six month period outperformed the benchmark, producing a positive return of 4.5% as against a benchmark of 2.3%. The main core assets of the strategy such as equities, bonds, infrastructure, emerging market debt and renewable energy all produced positive returns, but the main contributor to the investment return was equities. The strategy’s stabilising assets produced a small negative return.

2.7 Newton continues to believe that a determined focus on the longer-term trends, rather than short-term market news, is in the best interests of their clients. The portfolio is therefore maintaining a cautious investment position.

2.8 Schroders invests into property via a fund of funds approach where they invest in various different property funds to spread investment risk. There are two main investment areas, UK and Europe. Schroders have over the six month period just outperformed the benchmark by 0.2% producing a return of 3.8%. Schroders strong overweight position to the industrial sector has been the strongest driver of recent returns. They are still maintaining an underweight position to central London offices and the retail sector.

2.9 The fund with M&G is an alternative credit fund that invests in fixed income products such as corporate bonds, high yield bonds, asset backed securities etc. M&G produced a slight positive return of 0.4% but they underperformed the cash plus benchmark over the six month period by 1.4%. The fund’s performance was primarily driven by their industrial bond holdings. M&G continue to be relatively defensively positioned with the manager preferring financial and industrial sectors at present.

2.10 The overall Pension Fund investment return for the six-month period to end September 2018 was 9.0%, which was 0.3% below the benchmark return.

3.0 After the end of September 2018

3.1 Since the end of September 2018 equity markets have been falling on fears of higher interest rates in the US combined with worries about the US/China trade war. The large technology stocks which have been driving the US market were the hardest hit due to valuation concerns. All of the major equity markets fell during October as US concerns spread.

3.2 At the end of October 2018 the Pension Fund investments had a value of £483 million (unaudited).

3.3 The current investment strategy is at present under review. KPMG the Pension Fund's investment consultants are conducting the investment strategy review. The review is looking over the current strategy and will propose any changes to ensure the investment strategy remains fit for purpose over the next few years.

	Shetland Islands Council	Agenda Item **3**

Meeting(s):	Pension Fund Committee Pension Board	5 December 2018
Report Title:	Management Accounts for Pension Fund Committee: 2018/19 - Projected Outturn at Quarter 2	
Reference Number:	F-080-F	
Author / Job Title:	Jamie Manson, Executive Manager - Finance	

1.0 Decisions / Action required:

1.1 That the Pension Fund Committee and Pension Board RESOLVE to review the Management Accounts showing the projected outturn position at Quarter 2.

2.0 High Level Summary:

2.1 The purpose of this report is to enable the Pension Fund Committee and Pension Board to monitor the financial performance of the Pension Fund to ensure that Members are aware of the forecast income and expenditure position and its impact on delivery of the approved budget.

2.2 The report presents the projected outturn position for 2018/19 as at 30 September 2018. The forecasts have been determined by the relevant budget responsible officers within Finance Services.

2.3 The projected revenue outturn position at Quarter 2 for the Pension Fund is an under-achievement of £92k (1.4%), which means that the Pension Fund is projected to spend more than budgeted.

2.4 Further detail on the projected outturn position can be 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 maintains a balanced and sustainable budget and lives within its means; and that it continues to pursue a range of measures that enable effective and successful management of its finances over the medium to long term.

3.2 The investment strategy of the Pension Fund is aiming at achieving a 100% funding position by 2027, 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 2018/19 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 2, the Pension Fund is projected to have a year-end under-achievement of net income of £92k (1.4%); see Appendix 1 for an explanation of this variance.
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 existing strategy is to ensure that the Pension Fund is 100% funded by 2027. It is vital that the Pension Fund continues to receive a surplus of income over expenditure to ensure that the Fund can become fully funded and to keep the employers contributions at a manageable level. There are many factors within the Pension Fund transactions that can cause the actual outturn to differ significantly from budget, particularly within lump sums.
6.6	None arising from this report.

Assets and Property:	
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 lead to any residual liabilities falling to other scheme employers; • 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 the

	scheme regulations and the requirements of the Pension Regulator.
6.11 Previously considered by:	n/a

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Appendices:
Appendix 1 – Projected Revenue Outturn Position 2018/19

Background Documents*:*
Pension Fund Budget Proposals 2018/19, Pension Fund Committee/Pension Board, 6 March 2018
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=22165

Pension Fund Committee / Pension Board

1. Revenue Outturn Position 2018/19 (Quarter 2)

Budget v Projected Outturn variance at Q1 (Adv) / Pos £000	Pension Fund	Revised Annual Budget £000	Projected Annual Outturn £000	Budget v Projected Outturn at Q2 (Adv) / Pos £000	Expenditure and income to 30 September 2018 £000
2	Employee Costs	264	255	9	109
(3)	Operating Costs	145	244	(99)	113
0	Investment Expenses	1,573	1,599	(26)	372
0	Benefits Payable	10,557	10,557	0	4,299
0	Transfers Out	300	620	(320)	262
(50)	Lump Sums	2,003	2,076	(73)	1,096
(92)	AVC Out	480	480	0	432
(143)	**Total Expenditure**	**15,322**	**15,831**	**(509)**	**6,683**
(81)	Contributions Received	(17,569)	(17,679)	110	(7,168)
4	Investment Income	(3,394)	(3,598)	204	(1,113)
90	Transfers In	(300)	(403)	103	(403)
98	AVC In	(800)	(800)	0	(489)
111	**Total Income**	**(22,063)**	**(22,480)**	**417**	**(9,173)**
(32)	**Net Income**	**(6,741)**	**(6,649)**	**(92)**	**(2,490)**

An explanation of the significant variances to budget for the Pension Fund at Quarter 2 is set out below. At this stage it is difficult to predict some items of expenditure and income, owing to their demand-led nature.

1.1 Operating Costs – overspend of £99k (68.3%)

This overspend is related to tax on lifetime allowances, which occurs when someone has 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 - £320k (106.7%)

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.

1.3 Lump Sums – overspend of £73k (3.6%)

The value of lump sums payable to retirees varies greatly depending on a number of factors including length of service, salary, additional voluntary contribution (AVC) portion and whether there is automatic entitlement to a lump sum. The year-to-date position represents 48 retirees, analysed as follows:

- 29 normal retirements (£385k);
- 7 late retirements (over 65) (£64k);
- 6 ill-health retirements (£198k);
- 4 flexible / phased retirement lump sums (£72k)
- 2 redundancy/efficiency retirements (£61k).

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

Death-in-Service benefit lump sums are paid out at the rate of three times salary. Four payments in this regard have been made so far this year, amounting to £300k.

1.4 Contributions Received - over-achievement of £110k (0.6%)

This is a minor over-achievement relating to strain income for early retirements.

1.5 Investment Income – over-achievement of £204k (6%)

The outturn figure was calculated based on the year to date income and extrapolated.

1.6 Transfers in – over-achievement of £103k (34.3%)

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 year-to-date position consists of 7 transfers in at an average of £58k.

Shetland Islands Council

Agenda Item

4

Meeting(s):	**Pension Fund Committee** **Pension Board**	**5 December 2018** **5 December 2018**
Report Title:	**Scottish LGPS Restructure Review - Consultation Response**	
Reference Number:	**F-088-F**	
Author / Job Title:	**Jamie Manson, Executive Manager - Finance**	

1.0 Decisions / Action required:

1.1 That the Pension Fund Committee and Pension Board consider the consultation response to the Scottish LGPS restructure review (Appendix A).

1.2 That the Pension Fund Committee RESOLVES to approve that the consultation response be sent on behalf of the Shetland Islands Council Pension Fund to the Pensions Institute.

2.0 High Level Summary:

2.1 The Local Government Pension Scheme Advisory Board (SAB), at the request of the Scottish Government Cabinet Secretary for Finance and Constitution, is carrying out a consultation on the future of the Scottish Local Government Pension Scheme (SLGPS).

2.2 The consultation seeks to establish the views of employers and employee representative groups on whether outcomes for the members and sponsors of the SLGPS can be improved by altering the structure of the scheme.

2.3 The consultation asks employers and employee representative groups to consider the advantages and disadvantages of four options ranging from the current structure to consolidating the functions of the 11 Scottish Funds by collaboration or pooling or full merger.

2.4 The consultation is predominately focussing on the investment area of the Pension Fund and not at present the administration side. The consultation also has questions on the SLGPS investing in infrastructure projects.

2.5 Employer and employee representative organisations are asked to respond to the specific consultation questions in the form accompanying the consultation report and email responses to the Pensions Institute by Friday 7th December 2018.

2.6 The Pension Fund Committee and Pension Board received an initial background report on the SAB consultation on the 8th October 2018. A final proposed response has now been prepared to the consultation in line with the preferred option of the meeting on the 8th October 2018, which was to retain the current SLGPS structure. The final proposed response to the consultation from the Shetland Islands Council Pension Fund is attached as Appendix A. The response has been prepared in consultation with the Chair of the Pension Fund Committee as per the decision of the meeting on 8 October 2018 (minute ref: 19/18). The consultation response has also been circulated to the admitted bodies for their comment.

2.7 Shetland Islands Council as the main employer in the Shetland Islands Council Pension Scheme also received a background report on the SAB consultation on the 31 October 2018. From that meeting the Council agreed to submit a separate response to the consultation with the preferred option of retaining the current SLGPS structure.

2.8 A representative of Hymans Robertson LLP will be in attendance at the meeting to answer any questions on the LGPS Structural Review.

3.0 Corporate Priorities and Joint Working:

3.1 The report links to the Council's corporate priorities, defined in its Corporate Plan, specifically in relation to assisting the Pension Fund in ensuring that financial resources are managed effectively.

4.0 Key Issues:

4.1 The Scheme Advisory Board consultation document on the future of the SLGPS is basically a number of questions on four future proposed options. The four options proposed for consideration in the consultation are:

- Retain the current structure with 11 Local Authority Pension Funds
- Promote cooperation in investing and administration between the 11 funds
- Pool investments between the 11 funds
- Merge the 11 funds into one or more funds

4.2 The questions in the consultation follow a similar pattern for each of the four options. The questions cover certain areas which the SAB have identified as significant challenges for Pension Funds. These significant challenges are:

- Cost of investing
- Governance
- Operating risk
- Infrastructure investment

4.3 The deadline for responses from all employer and employee groups to the consultation is the 7th December 2018.

4.4 Responses go to the Pensions Institute for analysis and review before going onto the SAB for further evaluation. The results will then be presented to the Scottish Government Ministers in 2019 to decide on any future course of action.

4.5 Further information on the SAB consultation on the future of the SLGPS is attached as Appendix B.

5.0 Exempt and/or confidential information:

5.1 None

6.0 Implications:	
6.1 **Service Users, Patients and Communities:**	The report provides the stakeholders with information on the current SAB consultation on the future of the Pension Scheme. The outcome of the consultation could have wide ranging implications on the operation of the Pension Fund.
6.2 **Human Resources and Organisational Development:**	Currently the SAB consultation is gathering comments from employee and employer groups. Depending on which future option is preferred from the results of the consultation there could be changes to the local operation of the Pension Fund.
6.3 **Equality, Diversity and Human Rights:**	None
6.4 **Legal:**	There are no direct legal implications arising from this report however, legal advice and legal remedies will be sought and used whenever this is appropriate.
6.5 **Finance:**	There are no direct financial implications arising from this report.
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 SAB consultation is looking specifically at the future management structure of these assets, with four options for consideration, from maintaining the current structure to more cooperation, pooling and complete merger of the 11 Scottish Pension Funds.
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. All of the Pension Fund managers

	are 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:**	There are no risk implications from the report but the SAB consultation is looking at the future investment structure of the SLGPS, and depending on the results from the consultation there may be changes to the risk profile of the Pension Fund. 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	

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Appendices:
Appendix 1: Shetland Islands Council Pension Fund Consultation Response
Appendix 2: Information on the Scheme Advisory Board Consultation on the Future of the Scottish Local Government Pension Fund

Background Documents:
Scheme Advisory Board consultation and response document,
http://lgpsab.scot/consultation2018/

END

Review of the Structure of the Scottish Local Government Pension Scheme

CONSULTATION RESPONSE FORM

Instructions

Responses in this form should be drafted in conjunction with the accompanying consultation report. To respond, please complete the **respondent details** and as many of the **consultation questions** your organisation wishes to complete and return the form via email to the Pensions Institute at consultation@pensions-intitute.org no later than **Friday, 7 December 2018**.

This consultation is being conducted in electronic form only, so **responses must be emailed**; hard copy posted or delivered responses cannot be received. Any queries about the consultation should be addressed to Matthew Roy, Fellow, Pensions Institute at matthew.roy@pensions-institute.org.

RESPONDENT DETAILS

Name of responding organisation(s) Please list the full name of each organisation participating in this response.	**Organisation type** Is your organisation an administering authority, employer, or employee group? Please record for each responding organisation.
Shetland Islands Council Pension Fund	Administering Authority

Authors Please list any people that wish to be recorded as authors of this response, including name, job title and organisation.	**Consent** Please confirm each author consents to their information being retained for analysing the consultation responses by writing 'confirm' by their name.
Jamie Manson, Executive Manager – Finance, Shetland Islands Council	Confirm

Date
Please date the response.

date

Covering information
If you wish to include covering information with your response, please include the text here. The text can wrap onto additional pages if needed.

Shetland Islands Council is the Administering Authority for the Shetland Islands Council Pension Fund.

Key figures for the Shetland Islands Council Pension Fund as at the 31st March 2018 are as follows:

Membership

Membership	2017/18
Employee members	3,358
Pensioners	1,851
Deferred members	2,044
Total Membership	**7,253**

The population of the Shetland Islands at the 31st March 2017 was 23,200. The membership of the Shetland Islands Council Pension Fund is therefore equivalent to around 31% of the population.

Employers

There are 12 employers in the Fund with active members, this includes scheduled bodies and admitted bodies.

Funding

At the March 2017 triennial valuation the Fund had a calculated 90% funding level.

The main employer within the Fund pays a contribution rate of 20.8%. This rate was set at the 2017 triennial valuation and remains the same up to 2020/21.

Investment Assets

The Fund had a value of £459 million at the 31st March 2018. The Fund is invested in a diversified global strategy using five fund managers. All of the Fund's managers have signed up to the United Nations Principles on Responsible Investment as required by the Fund's Statement of Investment Principles.

The Fund's investment strategy is invested as follows:

Asset Class	Allocation %
Global Equities	40
Diversified Growth Fund	20
UK Equities	18
UK & European Property	12
Alternative Bonds	10

Investment Performance

3 years 7.1% p.a.

5 years 7.4% p.a.

10 years 6.2% p.a.

Fund Manager Fees

The current average level of fund manager fees for the Shetland Islands Council Pension Fund is 0.27% of the value of assets under management.

The consultation questions follow.

CONSULTATION QUESTIONS

Question 1: Retain the current structure with 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- *How well informed do you feel about the investment costs in your fund? What information do you rely on to specify and measure these?*

The Shetland Islands Council Pension Fund complies fully with the disclosure of investment costs as per CIPFA guidance in its Annual Report and Accounts.

All investment costs are reconciled from the fund manager's records on a quarterly basis and analysed between the different costs.

All investment costs are agreed at the initial set up of an investment management agreement with a new fund manager, and the new Code of Transparency requires further disclosure of fund manager's transaction costs.

All of the Shetland Islands Council Pension Fund investment fund managers are signed up to the Code of Transparency.

- *How well does the current system manage investment costs?*

Investment costs are discussed with investment consultants at the initial outset of an investment strategy review project. When interviewing prospective fund managers during a tender for a new mandate, the fund managers are questioned on their investment costs using the competitive situation to try and reduce costs.

An Investment Management Agreement with a fund manager always includes a section on investment costs so it is clear from the outset. There are other types of daily fund manager trading costs from purchasing and selling assets. Again these are reviewed against the turnover of investments to ensure this is appropriate for the agreed mandate.

- *How would you improve the measurement and management of investment costs in the current system?*

There have been recent developments in this area with the new Code of Transparency for LGPS asset managers, requiring them to provide cost collection templates. The FCA has also convened a working group to develop the existing cost templates further.

The competitiveness in the fund management industry has brought down costs over the past few years and the Code of Transparency is increasing the disclosure of costs, these measures by themselves are improving the measurement and management of investment costs.

b) Governance:

- *How well informed do you feel about the governance of your fund? What information do you rely on to measure this?*

In line with LGPS legislation the Fund established a Pension Fund Committee which discharges all functions and responsibilities in relation to the governance of the Fund, along with a Pension Board to assist with the compliance of scheme regulations and the requirements of the Pensions Regulator. The Pension Fund Committee and Pension Board meet at least quarterly to review all aspects of the fund's investments and administration. Both of these bodies are supported by officers of the Shetland Islands Council, investment consultants, actuaries, the custodian along with internal audit and other Council committees such as the Audit Committee that can review, check and scrutinise all aspects of the Pension Committee's work.

The Pension Fund also produces an Annual Report and Accounts which is an externally audited document. This includes an Annual Governance Statement which documents the governance arrangements for the Fund. The statement also evaluates these governance arrangements against the Code of Corporate Governance to ensure compliance with best practice and to identify any areas that require improvement. If any governance issues were found these would also be reported in the external auditors report on the Annual Report and Accounts.

http://www.shetland.gov.uk/finance/Pensions.asp

- How well is the current system governed?

The governance of the Scottish LGPS was reviewed and enhanced recently with new legislation and regulations, which resulted in the requirement to produce separate externally audited Annual Report and Accounts, and the establishment of a Pension Fund Committee and Pension Board for each Scottish LGPS. No significant issues have been highlighted by Audit Scotland which in itself suggests there are no significant governance issues with the individual Scottish Funds.

The governance of the Scottish LGPS is further supported by Council officers with external Independent Auditors that review and scrutinise all aspects of the Fund's operations. Finally, we take advice from external advisors who have extensive experience of the LGPS throughout the whole of the UK, and therefore helps us identify best practice.

- *How would you improve governance of the current system?*

The recent regulatory changes have improved the overall governance of the Scottish LGPS to a high standard, but ongoing review is to be welcomed. This could perhaps be best conducted by an independent audit to not only ensure all Scottish LGPS are compliant with the regulations but to assist and help with any areas of improvement.

- *How important is it to maintain a local connection with respect to oversight and strategy?*

It is imperative for accountability of decision making to maintain a local connection with respect to oversight and strategy. If Full Merger of Funds was decided, resulting in a Single Fund for LGPS Scotland, the local connection between the Fund's performance and the Employer contributions to the Fund would be lost.

A LGPS maintained and operated by officers and overseen by Committees within the main Scheme Employer on behalf of pension members of the same community with external scrutiny is a very high level of accountability and oversight. The local approach to the Scottish LGPS combines the benefit to scheme members within the community to the cost of the scheme to the local employers. This level of accountability and oversight would be lost with a merger option as employer contributions would be disconnected with local pension members. Any meaningful oversight by the scheme members and the employers would then be very remote.

The investment strategy is integral to the financial position of the pension fund and is specifically designed and implemented for the benefit of employers and employees. This is put together in conjunction with the contribution/funding strategy which is also set locally, as contributions are paid by the Council and other local employers. It would seem appropriate that there is a strong level of local accountability for the risk appetite inherent in the investment and contribution strategies combined, since these fall on the local employers.

The local scrutiny of the strategy by employers and employees through the current governance arrangements allows direct questioning at all stages of the strategy process. The increased disconnection of a merged Scottish fund could not allow this level of employer and employee scrutiny therefore lessening governance of the key interested parties.

The membership of the Shetland Islands Council Pension Fund in total is equivalent to about 31% of the population of the Shetland Islands. This shows how important to the local economy the pension fund is, and how important that there is a local connection to the oversight and strategy of the Pension Fund. The Fund sets its investment and contribution strategies locally, using a risk management framework which is appropriate to its local employers, and subject to local scrutiny: this approach has served the SLGPS well to date.

- *How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?*

It seems logical that local governance of something that is of importance to a local community is better served by those interested parties monitoring and deciding on issues. Removing a local connection makes it no less important to that community, and the level of importance and scrutiny cannot be replicated in any other type of organisation that is remote from the community.

Evidence of any other type of Scottish LGPS model is unknown and not tested, it is therefore difficult to quantify any costs or benefits as these could not be estimated with any real accuracy. Only the current Scottish LGPS position can actually be evaluated, and there is no evidence to suggest that the current model requires change, indeed all of the Scottish LGPS funding positions are very healthy irrespective of their scale, which is a direct output from good long term local governance.

c) Operating risks:

- *How well informed do feel about the operating risks of your fund? What information do you rely on to specify and measure these?*

The Shetland Islands Council Pension Fund has a risk register that is reviewed regularly.

External auditors undertake an annual assessment of the internal controls as part of their audit process. Furthermore, our external advisors work with us, providing specialist expertise drawing on extensive experience elsewhere in the UK LGPS, to help us maintain best practice in this area.

- *How well are operating risks managed in the current system?*

Both internal and external audit have not identified any significant issues in the Pension audits they have undertaken.

Operating risks are managed in all areas of the Fund, from internal and external audit reviews to having business continuity plans. Investment risks are paramount within the setting up of an investment strategy from the use of investment consultants, through to the diversification of fund managers and the independence of the custodian. Internally there are segregation of duties with all cash movements, and the reduction of key man risk through the involvement of various Council officers at all levels.

All internal and external use of risk control is used to mitigate all possible risk and safeguard assets, which is reflected in the external auditors clean audit report.

- *How would you improve the measurement and management of operating risks in the current system?*

Due to the complexity of the LGPS and other associated regulations, it's imperative to undertake continual staff development/training to ensure all pension administering staff are fully trained and multi-skilled so as to ensure key man risk is mitigated. Operating risks have been significantly improved now that all 11 Scottish Pension Administering Authorities are using the Heywoods Altair Pension Administration System. We are also making greater use of our external advisors to reflect the greater focus on these issues.

d) Infrastructure:

- *How well informed do you feel about your fund's investments in infrastructure? What information do you rely on?*

The Shetland Islands Council Pension Fund does not currently have any investments in infrastructure.

All investments are compared and analysed by our investment consultant before deciding which assets best fits into the Fund's investment strategy. The current investment strategy was agreed in 2014 and a review of this strategy has just been initiated with our investment consultants, with the intension to have a new investment strategy in place during 2019. This strategy may include infrastructure investments as it will be compared again to other asset classes during the consultant's analysis.

- *How do you rate the current system's ability to invest in infrastructure?*

Infrastructure will be evaluated against all other asset classes by our investment consultants, when they look at compiling the new investment strategy.

Infrastructure investing does have different governance characteristics, is more expensive to invest into, relatively illiquid and there are supply constraints. This does mean that investing directly into infrastructure requires specialist knowledge but there are different options to direct investing that could be utilised if the asset class was perceived to be a good investment for the fund's strategy, through to pooled vehicles already available and established in the pension investment universe.

- *How would you increase investment in infrastructure in the current system?*

Any investment into infrastructure would have to be recommended initially by our investment consultants and believed to be a good addition and diversifier within the investment strategy, relative to alternative investment options.

We do not treat infrastructure in a different way from consideration of any other asset class: the aim of the Fund is to balance risk and returns for the benefit of participating employers, ensuring the payment of benefits to all our members.

If there were a greater number of attractive infrastructure vehicles available it would increase the potential appeal of investment in this area. This is possibly where greater collaboration between the LGPS could assist with looking at prospective infrastructure products and assisting with the due diligence requirements.

e) Do you have any additional comments about this option?

To restructure the Scottish LGPS simply to secure additional investment in Scottish infrastructure could be a hugely costly mistake. If the Government's aim is to increase infrastructure investment, then it would be best achieved from the supply side (i.e. making suitable projects available for Funds to invest in) rather than mandating a demand for a limited number of opportunities.

The 11 Scottish LGPS Funds are all in a healthy position with good funding levels approaching or above 100%. This shows that the current system, with 11 Local Authority Pension Funds, is achieving security and protection over their member's future pension payments. This is the aim of a pension scheme and the Scottish Funds are achieving that aim. The saying of "if it isn't broken then don't fix it" appears relevant as the current Scottish LGPS Funds are in a good funding position. In particular, the consideration of pooling and greater focus on infrastructure in England and Wales has been borne partly out of a much poorer funding position south of the border than we experience in Scotland: importing solutions from other parts of the UK which are in very different situations is not necessarily appropriate for the Scottish Funds.

A restructure of the Scottish LGPS would be appropriate if the 11 Scottish Funds were in a very different situation with much lower funding levels, but given the current situation it is difficult to see what the overall benefit a change would make. There are many challenges for the Pension industry but these are being dealt with through proper governance and careful investment management, delivered by local decision-makers, as the results show.

If it is believed that infrastructure is a good long term risk/return asset class for the Scottish LGPS then it requires to be made more accessible and attractive for investment. This could be achieved through increased collaboration, such as the type of infrastructure product that Lothian has put together.

Question 2: Promote cooperation in investing and administration between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- *What impact do you think promoting agreements between funds would have on investment costs?*

Certainly any agreement between funds in relation to a joint procurement exercise would save costs and duplication of work. Any agreed investment, could also save time on due diligence work and save fund manager fees, given the cost structure that fund managers adopt which is based on overall investment size.

Some investment classes could become more accessible to the smaller Scottish LGPS Funds such as infrastructure, where due diligence work and ongoing governance could be covered by the joint agreement.

Costs are important but it is investment return net of costs which is the real measure.

- *What would be the positive impacts?*

Saving of costs and officer time in procurement and ongoing investment fees. An increased universe of possible investable asset classes.

- *What would be the negative impacts?*

Setting up and drafting the initial agreements between various Funds, could be time consuming and expensive and may be difficult to achieve agreement.

There could also be significant costs, delays and administration involved with getting revised investment processes put in place.

b) Governance:

- *What impact do you think promoting agreements between funds would have on governance?*

Initially introducing a new layer of cooperation and setting up agreements with other Scottish LGPS Funds would involve added governance at officer and committee level due to the new nature of the agreements and its complexity.

Once the agreements are in place and operating it would depend on the agreement itself but collective governance could actually reduce individual fund governance.

- *What would be the positive impacts?*

A collective approach to governance could improve the general governance of the investment, and help spread knowledge.

- *What would be the negative impacts?*

Initial discussions on the various aspects of any agreement would be a time consuming process. This process could be onerous and issues difficult to resolve due to the complexity of any agreement and the number of parties involved. All agreements need to be maintained, updated, reviewed etc.to everyone's satisfaction.

c) Operating risks:

- *What impact do you think promoting agreements between funds would have on operating risks?*

A new contract or agreement between funds will involve, at the outset, new operational controls and risks. This will require additional work initially but after that there should not be any difference to the ongoing operational risk, if anything there should be an improvement to operational risk, in particular key man risk.

The Scottish LGPS already has a good networking arrangement in place for the sharing of information, which includes the IGG and SPLG groups. These groups meet on a quarterly basis along with attending other group meetings such as the Heywoods Pension System bi-annual meetings (i.e. CLASS User Group).

More collaboration with the Funds can only be a positive thing by learning more from each other and would go some way to eliminating duplication of effort, in particular with regard to administration matters.

- *What would be the positive impacts?*

It depends on what the collective agreement is and how it is set out, but a collective management of risk must benefit operational risk.

- *What would be the negative impacts?*

A collective agreement will bring at its outset additional issues and work to satisfy risk management. Once the agreement is in operation it will require to be maintained and reviewed which will also require additional resources.

d) Infrastructure:

- *What impact do you think promoting agreements between funds would have on funds' ability to invest in infrastructure?*

An agreement between Scottish Funds on an infrastructure product would certainly be beneficial for most funds, as it would remove certain barriers that have prevented them from investing, such as lack of expertise in this area, the increased due diligence, governance required and the level of investment. An agreement would certainly give Scottish Funds the ability and opportunity to invest if it was as seen as an appropriate investment within their investment strategy.

- *What would be the positive impacts?*

It would give the opportunity for many of the Scottish Funds to invest in another asset class. There may also be benefits with scale to reduce management costs.

- *What would be the negative impacts?*

There is an increased collective risk and reduced diversification if many of the Scottish Funds invested in the same agreement with the same fund manager; if the returns were poor all of the funds would suffer. This is a greater risk the fewer opportunities there are.

e) Do you have any additional comments about this option?

Significant co-operation between the Scottish LGPS Funds and the wider LGPS network already exists. The introduction of the LGPS 2015, and the associated member and employer communications, was a successful large-scale collaborative exercise between all the Scottish LGPS Funds.

A collaborative agreement between Scottish Funds on infrastructure would open up this type of investment to many of the Scottish Funds that could not invest in this asset class individually.

Scottish LGPS Funds have worked together before on projects, so an agreement on an infrastructure product is certainly a realistic option, which would allow some of the Funds to get access to an infrastructure investment.

Question 3: Pool investments between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- *What impact do you think pooling investments between funds would have on the cost of investing?*

It is difficult to quantify costs as there is no evidence to suggest that large Funds have lower costs than smaller Funds. With the combination of past efforts by Scottish Funds, and the cost transparency developments, it would seem that the SLGPS is already in a good place

The initial setting up of the pool would be a costly and time consuming project, and it could take many years to recoup the set up and reorganising costs. This is evident from the experience in England and Wales. There would be an economy of scale benefit on costs when investing but any savings would be dependent on the type of investment, as all investments have different cost levels. There are also the significant ongoing costs of the staff managing the pool to be considered.

Reducing investment costs does not guarantee increased returns, so the effect on net-of-fees returns could quite possibly be minimal and out of proportion to the work and upheaval required to establish the Pools.

Pooling therefore looks to be costly to set up and manage which could take many years to recover. Some English & Welsh Funds will not reach break-even point for at least 10 years, and others will actively be worse off as a result of pooling, due to their positive starting point.

It appears there is no argument for pooling of Funds when the funding levels of the Scottish LGPS Funds are already good and fee levels are generally quite competitive.

- *What would be the positive impacts?*

A wider mix of asset classes could be available for investment due to the pool size. Investment strategy would remain under local control, which is crucial as identified above.

- *What would be the negative impacts?*

Costs from the initial set up of the pool could be very expensive. The time required to decide how the pool will actually be formed and function could run into many years, as England and Wales have found.

Large transaction costs to disinvest and reinvest, reduced selection of fund managers to achieve economies of scale, and possible unavailability of suitably qualified staff for the Pools, would increase investment risk. There is no evidence that a large Fund will save costs, and no guarantee of better investment returns.

- *If asset pooling were possible, under what circumstances should a fund consider joining an asset pool?*

If a Fund had a high level of fund manager fees, staffing issues and a poor funding level the merits of joining a pool structure might be considered.

- *Under which circumstances should the SLGPS consider directing funds to pool?*

It would require a situation where a fund was basically failing and not achieving its aims, and required outside help. An assessment of the fund's situation would need to be conducted to see if it would be beneficial for the fund to join a pool. However Government should take great care before forcing a Fund down a particular course of action which may increase a Fund's costs in excess of the potential benefits achieved.

b) Governance:

- *What impact do you think pooling investments between funds would have on governance?*

Pools would create another layer of governance and therefore further remove Pension Fund Committees and Pension Boards from the investments and fund managers. This adds to the complexity of the structure and reduces the Pension Committee's control and governance over the fund and its investment performance.

- *What would be the positive impacts?*

It is not clear what benefits there would be on governance from pooling investments. It is sometimes argued that the removal of investment manager decisions from local decision-makers would improve matters by focusing their attentions on the more important issue of investment strategy: however this brings into question why significant work is needed to address the lower risk issue of manager selection.

- *What would be the negative impacts?*

The work and time require to setup the initial pool would require additional resources of governance. Any structure that adds additional management layers such as a pool will increase the governance complexity and time allocated to the governance function.

Reduced ability to deal with poor-performing managers could be an issue: if the Pool is the designated manager but under-performs, how would a Fund remedy this situation?

c) Operating risks:

- *What impact do you think pooling investments between funds would have on operating risks?*

It is unlikely that there would be any impact on the operating risk with the investments as these would be invested with fund managers as per the current situation. . If anything there could be a negative impact due to the potentially limited availability of asset classes: the Funds would be restricted to choose from what the Pool had on offer.

It is unclear how the pools would tender for or select fund managers, and what level of choice of fund managers per asset class the Pension Committee would have.

- *What would be the positive impacts?*

It would depend on how the pool operated but due to the size and variety of the investments it may give an additional level of due diligence and risk control over the investments.

- *What would be the negative impacts?*

Pooling will decrease the choice of investment managers and asset classes, so increasing the concentration of the investments with the chosen fund managers. This will have a negative impact on investment risk and operational risk.

d) Infrastructure:

- *What impact do you think pooling investments between funds would have on funds' ability to invest in infrastructure?*

Pooling investments would give an additional size to the overall pool to allow it to consider offering an investment vehicle in infrastructure to the funds. Any fund considering an investment in infrastructure would still have to compare it to other investments and decide if it fits into their particular investment strategy.

Some of the Scottish LGPS Funds are already invested in infrastructure, so pooling may not achieve any sizeable change to the overall investment in infrastructure.

- *What would be the positive impacts?*

Pooling could offer an infrastructure vehicle which some Scottish LGPS Funds have not had the size or expertise to be able to invest into.

- *What would be the negative impacts?*

Setting up a pool for investments is a very expensive proposition to try and achieve an increase in infrastructure investment. This could be achieved more easily through the collaboration approach or simply investing in an existing investment pool or insurance contract.

e) Do you have any additional comments about this option?

The current Scottish LGPS structure is a success with all funds close to and exceeding a 100% funding level. To change this structure and introduce a pooled investment structure will create large initial set up costs, costs to reorganise investments plus the continued operational costs of the Pool. Agreement on how this structure would operate is unknown, as are the costs.

England and Wales have reorganised the LGPS into eight large pools, which has been under construction for a few years, and still has no known outcome on costs, investment returns or even actual agreements on some of the pool's structures. This does not set a good example to follow, especially when the Scottish LGPS position is well funded.

Fund manager fees in Scotland have reduced over the past couple of years making further savings through a pool more difficult.

Changing a structure will only add benefit if net returns after costs are improved, which is very unclear from the position in England and Wales.

There are 11 Scottish LGPS Funds all investing specifically for their Pension Funds using many different fund managers in different assets, which creates a very low risk diversified structure. A Pool would reduce the diversification of fund managers and asset classes, significantly increasing investment risk through concentration of investment. Pooling investments would create another tier of bureaucracy and would muddy governance responsibilities which in turn would increase operational risk.

Question 4: Merge the funds into one or more new funds

The text can wrap onto additional pages.

a) Cost of investing:

- *What impact do you think mergers between funds would have on the cost of investing?*

It is difficult to quantify cost savings as there is no evidence to suggest that large funds have lower costs than smaller Funds.

There may be cost savings with investing larger amounts but it depends on which asset classes, for example passive equities have seen fees slashed in recent years so any cost savings would be minimal. Some asset classes have an oversupply of investment so would be unwilling to cut fees.

Cost is only part of the investment picture as it is the investment performance return less costs that is important.

Reducing investment costs does not guarantee increased returns.

- *What would be the positive impacts?*

There is no evidence to suggest that larger funds have lower costs than smaller funds.

- *What would be the negative impacts?*

A reduction in costs does not guarantee an increase in investment return.

A merger would involve large set up costs plus disinvestment and reinvestment costs of funds reorganising to go into a merged fund. These costs are unknown but will be a drag on all of the funds positions for a long time, due to the great upheaval of arranging such a merger.

Scottish LGPS Fund costs are not excessive and the funding positions are good. Any merger would immediately add set up and reorganisation costs with no evidence that the merged fund will improve costs or investment return.

The costs of restructuring would be significant and could be a drag on fund performance for many years.

- *If merging were possible, under what circumstances should a fund consider a merger?*

Any options available to a fund should be considered but a fund would only consider alternative options such as merging with other funds if its analysis of that option proved to be a better outcome for that fund and its members. It is difficult to envisage such a situation given the known costs and delays in the short term, and the unknown (and possibly unavailable) cost savings in the longer term.

- *Under what circumstances should the SLGPS consider directing funds to merge?*

This step could only be considered if a fund was failing and required help. An assessment of the fund's situation would need to be conducted to see if it would be beneficial for the fund to merge.

b) Governance:

- *What impact do you think mergers between funds would have on governance?*

There would be a loss of governance over the fund, as local control and accountability would be diminished or completely removed depending on the merger model.

- *What would be the positive impacts?*

Saving on time and any costs relating to the governance of the fund at local level due to the decrease or ceasing of this function. This would only be a positive if the fund was ultimately in a better funding position with lower contribution rates and/or greater investment returns.

- *What would be the negative impacts?*

Governance of the merged funds would be further removed losing accountability from the fund employers and members. . The Funds assess contribution and investment strategies using a risk management framework which is appropriate to their local employers, and is therefore subject to local scrutiny and accountability: this would be lost under a merged arrangement.

c) Operating risks:

- *What impact do you think mergers between funds would have on operating risks?*

With a merged fund you would have a greater concentration of investment which would create increased operating risk. Poor performance by a fund manager would have a larger impact on the overall fund.

The merged structure and its governance arrangements would be paramount in managing operating risk, to ensure as a minimum that the current standards were maintained.

The larger merged structure would have more staff and resources to rely on, with more advanced risk analysis, to help control the greater mix and size of investments in monitoring operational risk.

- *What would be the positive impacts?*

More staff and resources available to check, monitor and review the investments, with more advanced risk analysis models, to help control the operational risk of the larger more complicated fund.

- *What would be the negative impacts?*

Greater range of asset mix will increase operational risk. Larger investments will have a greater concentration of risk, as well as breaking the local accountability link which currently serves the SLGPS well.

d) Infrastructure:

- *What impact do you think mergers between funds would have on funds' ability to invest in infrastructure?*

A merged fund may not offer an infrastructure investment. This would have no impact on the Scottish funds that do not at present have this investment but would remove the ability of any Scottish funds currently invested in infrastructure.

The increased size of a merged fund would increase the probability of having an infrastructure investment vehicle as part of its investment strategy, which would open up this investment to the smaller Scottish LGPS.

Some of the larger Scottish LGPS are already invested in infrastructure so merging may not achieve any sizeable change to the overall investment in infrastructure.

Whether it is a few funds merging together or all of the Scottish LGPS merging, the merits of investing in infrastructure would be reviewed against other investments, to see if it would be included in the investment strategy.

- *What would be the positive impacts?*

The merger of some funds or all of the Scottish LGPS could offer a direct infrastructure vehicle which was not available to some of the Scottish LGPS.

- *What would be the negative impacts?*

Some of the Scottish LGPS already invest in infrastructure so a merger would make little difference to their infrastructure investments.

The merging of different infrastructure investment would be very difficult and could ultimately increase concentration risk. Restricted options made available by the merged Fund may give rise to a negative impact for those Funds which would require a change in their infrastructure investment.

e) Do you have any additional comments about this option?

A merger of any of the Scottish LGPS Funds would not actually improve funding levels, as the merged position would simply be the sum of the current constituent positions: this is a major issue with this option.

The high funding levels of the Scottish LGPS Funds give reassurance to employers and members that the funds are currently being well governed and able to pay current and future pensions without requiring excessive contributions overall. This is paramount, and any change to this structure would need very good sound evidence to prove that the current good position could be improved for all interested bodies.

The current structure has been in place for many years and has proved that it works and can achieve its objectives. Any change from a successful structure is dangerous without being sure of the outcomes.

Question 5: Preferred and additional options

The text can wrap onto additional pages.

a) Which option does your organisation prefer? Please explain your preference.

Out of the four options in the consultation the Shetland Islands Council Pension Fund would prefer Option 1 to “Retain the current structure with 11 funds”.

The Shetland Islands Council Pension Fund at the last actuarial valuation in March 2017 had a calculated funding level of 90% on a prudent basis, which maintains a good ability to cover current and future pensions. This level of funding along with strong governance shows that the fund is well placed for the future.

When you add up all the fund’s current members, deferred members and pensioners the total comes to about 31% of the population of the Shetland Islands. The fund is therefore very important to not only the members, but for the future income and benefit of the Shetland community. Local employers pay the required contributions and bear the investment risk, all under a framework of local scrutiny. Any option to remove local control of the pension fund would require very strong evidence to show that it would be beneficial to the fund and its membership and employers. The options proposed to pool and merge funds have many issues which have unknown outcomes, and they do not have the level of evidence or assurance to make them viable alternatives.

The fund has benefitted from the already significant cooperation between the Scottish LGPS and it would be good to see this continue with further collaboration on issues relating to both investment and administration, which would help enhance the fund’s position.

b) What other options should be considered for the future structure of the LGPS?

The Scottish LGPS have good funding positions and have proved to be a long term success but there are many challenges within the pension domain. This is not an unusual situation and does not require any sudden changes to the scheme but the cooperation between funds could be enhanced with more collaboration on some of the more challenging issues. A recent example of this would be the joint collaboration on infrastructure investment between Lothian and Falkirk.

c) What would be the advantages and disadvantages of these other option for funds’ investment costs, governance, operating risks and ability to invest in infrastructure?

A collaborative approach on specific pension issues between the Scottish LGPS would allow their combined knowledge and understanding of the issues to be discussed and solutions worked out to the benefit of the funds and their members. This type of joined approach would always discuss the long term costs, governance and the operational risks.

The ability to invest in infrastructure is again a choice of each fund, based on the merits of that investment against other investments. The collaboration of certain

Scottish funds has already witnessed an instance where the ability to invest in infrastructure was realised.

d) Are there any other comments you would like to make?

The consequences of a large change could have long term detrimental effects to the Scottish pension position, the members and many employers. With a lack of evidence for any change and many unknown outcomes the options to pool and merge appear to present little positive benefit but significant potential costs, upheaval and risk.

Major changes to the operation of the Scottish LGPS should only be considered if there were large problems with the current situation. This is clearly not the case as the Scottish LGPS have good controls in place and have strong funding levels, which this consultation will demonstrate.

The consultation questions end.

Appendix B

Information on the Scheme Advisory Board Consultation on the Future of the Scottish Local Government Pension Scheme

1.0 A review of the SLGPS was agreed with stakeholders and the Scottish Government Ministers when the changes to the scheme and the new Scheme Advisory Board were introduced in 2015.

1.1 The SAB proposed carrying out this review beginning in 2016. The SAB commissioned research pieces by Mercer (investment consultants) in 2016 and Iain Clacher at Leeds University in 2017, as well as setting up a working party comprising employers, trade unions and fund advisors. From this research the SAB released its own report in 2017.

1.2 The research concluded that Scottish pension schemes face a number of significant challenges and, as a result, the current structure of the scheme in Scotland which has 11 Local Authority Pension Funds should be reviewed. A selection of these significant challenges include: the deficit; investment management costs and their transparency; investment performance; volatile investment markets; low interest rates; a maturing scheme membership and the consequences of implementing investment preferences in respect of certain assets, such as fossil fuels and infrastructure.

1.3 Based on this research the SAB report identified four options for the future of the local government pension scheme in Scotland.

1.4 The four options proposed are:

- Retain the current structure with 11 Local Authority Pension Funds
- Promote cooperation in investing and administration between the 11 funds
- Pool investments between the 11 funds
- Merge the 11 funds into one or more funds

1.5 The four proposed options were presented to Scottish Government Ministers in May 2017. In January 2018, SAB received a letter from Derek Mackay MSP, Cabinet Secretary for Finance and the Constitution seeking a consultation with SLGPS employers and employee membership bodies on the four options.

1.6 The SAB has commissioned the Pensions Institute to manage the consultation process on the structural review of the SLGPS. The consultation invites employers and employee representative groups to give their views on each of the four options. The consultation was launched during June 2018.

1.7 The SAB's 2017 report sets out the four main options for the local government pension scheme, and the consultation questions focus on four criteria in relation to each option:

- Cost of investing: This is the biggest outlay by each fund in the SLGPS and research suggest even small reductions in investing costs and, in particular, investment manager fees could have a significant impact on fund performance.

- Governance: Numerous studies show that improving governance produces significantly better outcomes over the long-term and that most pension funds in both the private and public sectors have room to improve in this area.

- Operating risks: Believed to vary significantly among public and private sector pension funds depending on the effectiveness of the governance processes of each fund and the quality of the executive resources available to individual funds.

- Infrastructure investment: There is an increasing political desire that SLGPS funds be able to invest pension assets in infrastructure should they decide it to be in the interest of members and employers.

1.8 The cost of investing, governance and operating risk are all issues which pension schemes consider and review. Infrastructure investment is rather different as it is an actual investment sector, one of many that would be considered by pension funds when setting an investment strategy. The foreword to the consultation is by Derek Mackay MSP, and it states "The Scottish Government is ambitious for greater investment by local government funds in Scotland's infrastructure."

1.9 The consultation is open to SLGPS employers and employee representative groups only. To have their views heard, they should respond to the questions no later than Friday 7th December.

1.10 Responses gathered from the consultation will be analysed by the Pensions Institute and the then forwarded onto the SAB for evaluation, before being presented to Scottish Government Ministers in 2019 for a decision on any future course of action. As well as this consultation, Ministers will also take into consideration a governance review of public sector pensions being undertaken by the Scottish Public Service Pensions Agency.

1.11 The four options proposed in the SAB report which employee and employer groups are asked to consider could have very different impacts upon the Shetland Islands Council Pension Fund:

- Retaining the current 11 Local Authority Pension Funds. This is the status quo option, and there would be no change to the present governance, operation and investment of the Pension Fund.

- Promoting cooperation in investing and administration between the 11 funds. The administration officers and the investment officers of the 11 funds already meet quarterly and share information. This would increase the current cooperation, in certain specific areas where beneficial between the Scottish funds. This would involve having a closer working relationship with the other 11 Pension Funds.

- Pooling of investments between the 11 funds. This is following on from England and Wales where 89 funds combined into eight large pooled funds. This option for Scotland would see the 11 funds made into one Scottish Pool, involving the setting up of a new committee and officer operation to look after the Scottish investment pool. Shetland's Pension Fund would still operate similar to before but would only be able to invest in the selection of fund managers that the pool recommended. Costs and benefits would be unclear with this arrangement until the pool structure was operating, but it would add another layer of governance between the fund and the fund manager, with a reduced fund manager investable list.

- Merging the 11 Scottish Funds into one or more funds. This would remove all local control and involvement in the Pension Fund from the Council. The new Scottish Fund would have responsibility for all of Scotland's pension investments. There would be no requirement for a Pension Fund Committee or Pension Board, no involvement in the investments and there may be staff issues if administration was included. The Shetland Pension Fund would no longer have any local control.