

Report Title:	Review of Pension Fund Governance Report
Contains Confidential or Exempt Information?	NO - Part I
Member reporting:	Councillor Julian Sharpe, Chairman Berkshire Pension Fund and Pension Fund Advisory Panels
Meeting and Date:	Berkshire Pension Fund and Pension Fund Advisory Panels – 19 October 2020
Responsible Officer(s):	Andrew Vallance, Head of Finance and Deputy Section 151 Officer
Wards affected:	None

REPORT SUMMARY

1. This report presents to Members the outcomes of an independent review of Pension Fund governance following receipt of an adverse ISA260 report issued on 6 December 2019 by Deloitte, the Borough's external auditor.
2. The final version of the independent report can be found at Appendix 1.

1 DETAILS OF RECOMMENDATION(S)

RECOMMENDATION: That Panel

- i) **Considers and notes the Independent Governance Report at Appendix 1.**

2 REASON(S) FOR RECOMMENDATION(S) AND OPTIONS CONSIDERED

- 2.1 The Royal Borough of Windsor & Maidenhead (RBWM) is the administering authority for the Royal County of Berkshire Pension Fund (RCBPF). RBWM has a statutory duty to maintain the Fund in accordance with The Public Services Pension Schemes Act 2013, associated Local Government Pension Scheme (LGPS) Regulations and wider pension legislation.
- 2.2 An adverse ISA260 report issued on 6 December 2019 recommended that an independent review of Pension Fund governance should be undertaken.
- 2.3 The independent report can be found at Appendix 1 and has been used to inform a wider restructure of the Pension Fund to be set out in a separate report to Members.

3 KEY IMPLICATIONS

- 3.1 Failure to consider, review and implement a robust governance structure could lead to sanctions being imposed on RBWM by the Pensions Regulator when it comes to its management of the Pension Fund.

4 FINANCIAL DETAILS / VALUE FOR MONEY

4.1 Failure to monitor investment performance in line with appropriate strategies could lead to an increased Fund deficit resulting in employers having to pay more.

5 LEGAL IMPLICATIONS

5.1 The Administering Authority is required to govern and administer the Pension Scheme in accordance with the Public Service Pensions Act 2013 and associated Local Government Pension Scheme Regulations. Failure to do so could lead to challenge.

6 RISK MANAGEMENT

Table 1: Risk Analysis

Risks	Uncontrolled Risk	Controls	Controlled Risk
Pension Scheme not governed in line with legislation	Medium	Internal and External Audits	Low

7 POTENTIAL IMPACTS

7.1 Failure to comply with Pension legislation could result in the Administering Authority being reported to the Pensions Regulator where failure is deemed to be of a material significance.

8 CONSULTATION

8.1 Not Applicable.

9 TIMETABLE FOR IMPLEMENTATION

9.1 December 2020

10 APPENDICES

10.1 The appendices to the report are as follows:

- Appendix 1 – Independent Pension Fund Governance Report

11 BACKGROUND DOCUMENTS

Not applicable

12 CONSULTATION (MANDATORY)

Name of consultee	Post held	Date issued for comment	Date returned with comments
Cllr Julian Sharpe	Chairman – Berkshire Pension Fund Panel		
Adele Taylor	Director of Resources and Section 151 Officer		
Ian Coleman	Interim Pension Fund Manager		

REVIEW OF PENSION FUND GOVERNANCE FOR ROYAL BERKSHIRE PENSIONS FUND and ROYAL BOROUGH OF WINDSOR and MAIDENHEAD

Background

1. Following an adverse ISA 260 Report by the External Auditor of the fund , (Deloitte) I have been requested to undertake a review of the governance arrangements of the fund . The full terms of reference are appended as Appendix 1.

Glossary of Abbreviations

- FSS- Funding Strategy Statement
- ISS-Investment strategy statement
- IWG -Investment Working Group (AKA Berkshire Pension fund Panel subcommittee)
- LGPS- Local Government Pension Scheme
- LPP-Local Pensions Partnership (also includes Local Pension Partnership Investments)
- RBPF- Royal Berkshire Pension Fund
- RBWM – Royal Borough of Windsor and Maidenhead
- SAA- Strategic Asset Allocation

Structure of the Report and Recommendations.

2. Following a statement of the statutory background which sets out the Council’s role as the administering authority for the pension fund. The report is based on the requirements of the terms of reference ,within that the following themes and topics have been identified for investigation, based on the terms of reference : Council Governance, Impact of pooling , USA Distressed Energy investment , Role of the independent advisors and asset valuation. Recommendations for further action by either RBWM and/or RBPF have been included at the end of each theme or topic. These recommendations were made on the basis of the review and research undertaken in February 2020 and relate to the situation at that time, they do not reflect any changes that have occurred since then.

Statutory Background

- 3 The Royal Borough of Windsor and Maidenhead (RBWM) is the Administering Authority for the Royal Berkshire Pension fund (RBPF) having had this responsibility transferred to it under section 7 of the Berkshire structural change order 1996. Responsibility for the Pension fund was assumed with effect from 1st April 1998 . At that time, the primary legislation governing Local Government Pension funds was the Superannuation Act 1972.
- 4 As Administering Authority , overall responsibility for the fund rests with the Council, as the 1996 order states, it takes on the rights and liabilities of the fund. The fund is not only a separate organisation but is also in law part of the Council. In 2013 the Public Services Pensions Act became law and introduced a revised statutory framework under which the Local Government Pension Scheme (LGPS) operated . Under that Act the Local Government Pensions Scheme Regulations were issued . These regulations cover the main duties of an Administering Authority which broadly fall into two areas : Administration of employee’s pensions (including collection of both employee’s and employer’s contributions) and investment of those contributions to ensure that the fund is solvent, and that Pensions can be paid .
- 5 Traditionally , within the broad scope of regulations issued under the Superannuation Act how monies were invested was a local decision and as such investment decisions were made

at a local level . However, over the past few years the Government have indicated that they expect Administering Authority's to pool investments. The LGPS Investment Regulations issued in July 2016 and the statutory guidance issued under those regulations on preparing and maintaining investment strategy statements clearly show how the Government could choose to intervene in the event of a Council failing to pool investments. This guidance builds on the 2015 guidance" Local Government Pension Scheme: Investment Reform Criteria and Guidance", this guidance clearly states the Government's intention to have most if not all LGPS assets pooled.

Council Governance.

- 6 Although RBWM has responsibility as a Council for the RBPF it does in common with other Administering Authorities delegate this to a committee or panel of members. It should be noted that Pensions falls outside the remit of the Executive being excluded from being an executive function under the Local Government Act 2000. The current RBWM Pension Panel consists of five councillors. In addition to the Panel there is a wider group the Advisory panel which consists of the five Councillors from RBWM , One elected representative from each of Reading Borough Council, Slough Borough Council, West Berkshire Council, Bracknell Forest Borough Council and Wokingham Borough Council; Two trade union employee representatives; Three representatives from employer bodies with the Fund: University of West London; an employer with a minimum of 200 members within the Fund; a representative from an Academy (to represent all academies within the Fund) ; one member drawn from the active membership, and one member drawn from the deferred/pensioner membership. The Advisory panel and Pensions Panel in effect become one body meeting at the same time , but decisions relating to the administering authority functions are only taken by the five RBWM members.
- 7 In addition to the above two bodies there is at present an investment working group (IWG) which is formally a subcommittee of the Pensions Panel. In the Council's constitution the body is known as Berkshire Pension fund Panel Sub Committee. Until recently , the IWG consisted of "the Chairman and/or Vice Chairman of the Berkshire Pension Fund Panel, and up to three other members of the Berkshire Pension Fund and Pension Fund Advisory Panels". At a recent Panel meeting changes to this membership together with changes in the terms of reference were noted. This reduced the number of other members down to one but added two independent advisers to the IWG. This proposed change in membership and the change in terms of reference have not been instituted in line with the Council's constitution where changes to delegated non-executive functions would normally be approved by Full Council.
- 8 There is a final body involved in oversight of the RBPF and that is the local pension board , these are a requirement of the 2013 Public Services Pensions Act and consists of a mix of employee and employer members meeting four times a year reviewing the work of the Pensions Panel , advisory Panel and IWG.
- 9 The above structure has been subject to a recent review to reflect the fact that the RBPF has since June 2018 had no new directly managed investments following the pooling of the RBPF's assets into a Pool managed by the Local Pensions partnership (LPP). The structure of the advisory panel pre dates the establishment of the Pension board and in reality it could be a quite cumbersome meeting if everyone attended this could be reduced by eliminating the member reps , Trade union reps and the three non-Council employer reps and instead

reviewing the membership of the Pensions board so that the Advisory panel becomes a purely Councillor Panel. By shifting the balance between the two bodies and by ordering business so that the Pensions board normally has sight of the Pensions Panel / Advisory panel work in advance of that meeting would assist scrutiny as the board's comments would be known in advance of the Panel needing to make a decision. It should be noted that the most recent agenda for the Pensions Board (as at February 2020) follows that pattern on most issues.

- 10 The role of the IWG has changed post pooling and this is reflected in the revised terms of reference. There has to be some question as to whether it has a long-term future as it no longer has responsibility for direct investments. However, until the matters raised by the Auditors are fully resolved, and relations with LPP reach a steady state, the IWG has a role to play in holding LPP to account. However, this should be reviewed in two years' time. The level of involvement in the IWG is unsatisfactory, at present there are only two Councillors on the IWG, and the number should be increased to four ideally. The revised terms of reference currently allow for two independent advisors. The role of advisers will be dealt with separately in this report, including their role at meetings.
- 11 It is important that members of both the Pension Panel and the Advisory Panel are able to demonstrate that they have adequate experience and training which is current and updated. A recent internal Audit report highlights that for a number of years some Panel members have not been completing training records, this needs to be rectified.
- 12 It is normal within a local authority for meetings to be clerked by an authority's democratic services team. This was not the case for the IWG which was initially clerked by the pensions team and has subsequently had informal notes taken by one of the Independent advisors. This is unsatisfactory as a good accurate record of decisions taken are key to determining a record of how things were decided as well as providing a record of discussion. This role should in future be undertaken by the democratic services team. It is also noted that there is no record of meetings of the IWG appearing on the Council's website, it is assumed that all of the discussion's therein were previously covered by the public exclusion provisions of Section 100 (A) (4) of the Local Government Act 1972, but this declaration is not included on any of the papers. Even if the whole Agenda is exempt, information details of when the meeting is and the reason why it is exempt should be a matter of public record and publication. It is also important due to the sometimes, technical nature of the minutes that minutes of the Panel and IWG are checked by a senior member of the Pensions staff and /or finance team prior to publication.
- 13 In summary, the following recommendations are made to RBWM and RBPF:
 - The size of the Pensions Advisory Panel should be reduced so that it only includes Councillor representatives. Training records need to be completed annually.
 - The Pensions board membership should be reviewed to reflect the above change and membership amended accordingly.
 - That the membership of the IWG should be four councillors and its future reviewed in two years' time. Advisers as appointed by the Council should be entitled to attend and speak but not vote.
 - The above changes to be approved in line with the Council's Constitution.
 - That all meetings should be properly clerked and minuted and that minutes are checked prior to publication. In addition, details of all meetings should appear on the Council's Website with reasons why the meeting items or meeting itself are classified as exempt information.

Impact of pooling.

- 14 The Government have for a number of years been pushing the LGPS funds in England and Wales towards pooled vehicles with the intention of creating larger investment pools. In the early days of pooling RBPF had discussions with the neighbouring funds of Oxfordshire and Buckinghamshire (Project BOB), but no consensus on the way forward was possible, this is understood to be due to the investment style of RBPF which differed to the other two funds. Between 2015 and 2017, the Pensions Advisory Panel received ten different papers on pooling. From the tone of those papers and from discussions it is clear that in common with a number of other LGPS funds RBPF were reluctant poolers.
- 15 During 2016, for a variety of reasons, the choice of pooling options diminished and RBPF had in reality a single option which was to join LPP, which is the smallest of the pools established with only two other members. The formal decision on this was eventually made in January 2018, following threatened intervention by the Minister of State. Pooling became operational from the 1st June 2018 with LPP taking over responsibility for all day to day investment decisions, however these had to be taken in line with the RBPF Investment strategy statement (ISS), Strategic Asset Allocation (SAA) and Funding Strategy Statement (FSS). Since June 2018, the RBPF assets have transitioned gradually into the LPP funding structure which consists of eight "buckets". At transfer date about 1/3 of the RBPF was not immediately poolable being illiquid assets, much of which had been investments undertaken during the previous two/ three years. The agreement between LPP and RBPF had a section on transitional arrangements which dealt in particular with the illiquid assets termed legacy assets. In that agreement although these were managed by LPP they are still owned by RBPF. The agreement is silent on who deals with issues of valuation either in year or at the end of the financial year with regard to these assets and the relationship with the Custodian, the role of the Custodian is described later.
- 16 Prior to pooling RBPF had an in-house investment team of four staff. Upon pooling this staff group was either made redundant or were TUPE transferred to LLP. However, under the agreement with LPP there are a number of functions that remain the responsibility of RBPF. These are detailed in clause 4 of the agreement. These are shown in detail in Appendix 2. However, there is no evidence that RBPF has given regard at an officer level or formally at a member level as to how these functions will be undertaken or resourced and also how the function of just checking what LPP undertake will be carried out. This task fell initially to the former section 151 officer and the current Pensions Services Manager, neither of whom had significant past experience in Investment related matters. Following Pooling there is evidence that some consideration was given at a member level on future structure as an informal meeting took place between two Councillors and an Independent Adviser in June 2018, but this did not impact on the officer arrangements. In effect since June 2018, the non pooled assets have had minimal oversight as have LLP. With Trust being the apparent primary method of control.
- 17 The absence of informed officer advice is apparent in another respect. At present RBPF is in the final stages of completing an updated ISS, however there is no professionally informed officer oversight of this important task which is being undertaken largely by the Investment advisers using I understand a draft prepared some time beforehand by the former Pensions Manager, this by definition is now out of date. This is an important document that needs to reflect in particular the need for the funding level to grow as the fund is and has been for the past two triennial valuations poorly performing in relation to other LGPS funds, this is in contrast to 2007 when RBPF was one of the best performing funds nationally. The funding

deficit within the RBPF contributes to the budgetary issues of the Berkshire Unitary authorities.

- 18 A normal sequence of events would be for ISS to be revised after the FSS had been revised following the final receipt and agreement of the 2019 triennial valuation , this would then feed into a revised SAA and then the revised ISS. The ISS was approved with the FSS in May 2018 and then reviewed in March 2019 . The ISS has to be reviewed at least every three years , therefore the absolute deadline for this next review to be agreed is March 2022.
- 19 The finalisation of the ISS needs professional experienced input at officer level . This would enable the fund to show that it meets the “Proper Advice” requirement under the regulations . Proper advice does not only include independent investment advice. In addition, revised guidance from the government is still awaited on how to deal with a range of other issues such as Climate change and boycotting certain types of investment. In the light of this it is suggested that the agreement of an updated ISS is postponed, and that the ISS is updated once the FSS has been reviewed and in the light of Government guidance.
- 20 The absence of an informed client to undertake residual duties under pooling, to supervise LPP, to provide input into the ISS and FSS and to provide a professional contact point needs to be rectified. Within LPP both of the other two funds have kept client-side staff as is the case in every other LGPS fund I am aware of. It is therefore imperative that arrangements are put in place to ensure there are adequate resources to undertake this function .There are a number of possible options , these are outlined below.
 - RBPF could employ an officer to undertake these tasks. The role would need a good knowledge of the investment arrangements of the LGPS and an understanding of the risk appetite of the RBPF. The downside of employing a single officer is a lack of resilience in times of absence and there is probably a limited pool of people who would wish to undertake this work.
 - RBPF could employ a third-party private firm . Entering into a contractual relationship would give resilience which employment might not but there are risks associated that the organisation may not fully understand the requirements of RBPF.
 - RBPF could enter into an agreement with another LGPS administering Authority to undertake those functions on its behalf. This could provide both the resilience and expertise required ; however, the downside is that there may well be a premium to pay due to RBPF previous track record.Although none of the above is a perfect solution , the third option should provide both the resilience and expertise that RBPF require to undertake this role.
22. One of the roles of the RBPF in house investment team would have been to liaise with the Custodian . The role of the Custodian includes holding the assets of the fund in safe keeping , to verify that they exist and to value the assets. They also play a key part in transitioning investments between different asset classes. RBPF have used the same Custodian since 2011 for this function without significant issues at Audit. Since June 2018 , a process of transitioning assets held on RBPF’s balance sheet to investment pooling vehicles managed by LPP has been underway . This process has the effect of reducing the number of underlying assets RBPF has responsibility for through its own custodian (Legacy custodian) and replacing them with fund interests in LPP’s investment pooling vehicle. LPP have their own custodian arrangements managed and overseen by LPP.
23. However , many of the more Illiquid and difficult to value assets remain directly held by RBPF with the legacy Custodian . LPP have stated that they have no responsibility for the management and oversight of the legacy Custodian. Although under the transition arrangements LPP have responsibility for management of the assets. It is unclear since June

2018 what supervision, if any, RBPF has given to the Legacy Custodian and it is likely that this lack of attention to the role of Custodian for those assets still with the Legacy Custodian contributed to some of the issues raised by Deloitte in the Audit. This issue should have been foreseen in the discussions which took place prior to pooling and greater clarity in the agreement for responsibility of these assets should have been sought in particular defining what is meant by "management". No evidence has been presented that these were considered at any level within RBPF and as such no provision was made for the direct supervision of those assets, which in my view contributed directly to the situation outlined in the auditor's report.

24. In future, and in order to prevent this re-occurring for the 2019/20 Audit it is important that responsibility for management and oversight of RBPF's custody services is owned by RBPF. It is therefore suggested that discussions take place urgently with the Legacy Custodian with the support of LPP and the attendance of Deloitte to ensure that for those assets, still within the Legacy Custodianship, so that arrangements are in place to ensure that the 2019/20 audit runs smoothly as ultimate responsibility will rest with RBPF. Longer term, the agreement with LPP should have more direct reference to LPP's and RBPF's respective responsibilities for verifying valuations for all assets, for agreeing timescales for information during account closure and for liaising with the auditors
25. The role of the Legacy Custodian should be reviewed in the light of the change in scope post pooling. Discussions will need to take place with them and other providers including the LPP custodian to determine the most economical course of action for those mandates still with the Legacy Custodian.
26. In the light of the above both the RBPF and RBWM need to consider how to rectify the above and the following recommendations are made, to ensure that there are adequate resources to provide controls in the future.
 - That the decision to approve an updated ISS is postponed and that before the ISS is approved that it is checked to ensure that it meets the requirement to provide a performance level that will reduce the funding deficit for the RBPF
 - That arrangements be made to provide officer support to enable RBPF to meet its residual direct functions post pooling.
 - That discussions take place with the Custodian, Deloitte and LPP to ensure that for those assets still within the Legacy Custodianship that arrangements are in place to ensure that the 2019/20 audit runs smoothly.
 - That discussions take place with LPP to agree timescales and agreed processes for valuations during account closure and the agreement is formally amended to reflect these processes and timescales.
 - That discussions take place with the Legacy Custodian and other providers including the LPP custodian to determine the most economical course of action for custodian services for those mandates.

USA Distressed Energy Investment

27. From early 2016 the RBPF undertook a broad range of investment activities in what can broadly be described as investments in real assets. This report does not comment on the wisdom of this investment approach only on the process by which the investment decision was made. Papers with investment proposals were submitted by officers to the IWG and where they were above the delegated limit of £50 Million the final decision to invest was made by the Pensions Panel. One such proposal was to invest in distressed Energy in the

USA. As the investment was below £50 Million the decision was a delegated decision to the IWG. Somewhat unusually the decision to make the investment was made via what was in effect a remote meeting of the IWG.

28. The Constitution of the IWG allows for meetings to be held electronically and for decisions to be made in that way as long as they were subsequently recorded and minuted. There is no record, however, that I have seen, of any assent or dissent to the decision being taken by the voting members of the IWG. It is assumed that the decision was made on the silence is assent principle. This was a clear breach of the requirement to minute electronic meetings
29. A second tranche of investment was made in March 2017, by that time the oil wells acquired had been visited by officers who then by email sought the assent of the IWG to further invest in line with the initial proposal, which allowed for a second tranche of investment once certain production schedule targets had been produced. The only email seen in response was from one of the Independent advisors who supported the proposal subject to their being no change to the original. Again, there is no record of assent or dissent to the proposition.
30. As stated, the Council's constitution does allow the IWG to operate electronically. However, to do that effectively there needs to be a thorough audit trail properly recorded and centrally retained of how the decision was made to invest. No record has been found of this and evidence of what has occurred when has only been compiled due to IWG members not deleting emails. For an investment of \$50 million better recording of decisions should have occurred. To some extent any recommendation on this is now academic as post pooling the RBPF no longer has responsibility for individual asset acquisition as that decision is made by LPP in line with the SAA and ISS. However, as a matter of Policy any decisions taken by electronic meetings must be properly recorded.
31. There is a second issue arising out of the Investment which was the fact that the Pension Fund Manager was appointed a Director of the Organisation and remained one after he left the Council's service until his death. The offer of the directorship was noted at the July IWG meeting, but no formal record of this being accepted has been produced. In addition, a check on officer's declarations of interests also shows that no return was made by the Pension Fund Manager for either 2016/17 or 2017/18. The absence of these declarations taking into account the reference in the IWG minutes shows a lapse of governance.
32. It is not unusual for a significant investor in equity to appoint a director to a company as often the shareholders and the company's interests are aligned. However, it is unusual for the owner of publicly issued debt to appoint a shareholder as in moments of potential distress the interests of the company and the debt holder may be diametrically opposed.
33. As with the investment issue referred to above, the fact that LPP now undertake the investment decisions means that there is now no scope for RBPF to appoint Directors to firms which they invest in. However, there may be other parts of the Council where directors or trustees are appointed to third party bodies or Council owned companies and either no declaration of interests are made or there is no arrangement for the appointee to be removed once they are no longer employed by or a member of the Council or earlier should the Council decide that they no longer wish that individual to serve.
34. RBWM are recommended to
 - review any arrangements that it might have for meetings and decisions to be taken electronically and that review should include the requirement for an accurate record as to how the decision was taken.
 - Ensure that for any Organisation where the RBWM appoints a director or trustee that declarations of interests are completed and that both the organisation and the individual are

aware that the appointment is only for the period of time the individual is either an Officer or Member or the Council or earlier should the Council decide.

Role of the Independent Advisers

- 34 Under section 7 of the LGPS (Management and Investment of Funds) Regulations 2016 RBPF has to take proper advice when preparing its ISS. This is one of the key functions of the external investment advisers appointed by RBPF. The RBPF has three different advisers one appointed to advise the panel and two for the ISS.
- 35 The panel adviser was initially appointed in 2013 , for a three-year period which has subsequently been extended annually. The contract refers to the services being required as being investment advice with no definition as to what that might be in detail. The view of the members and officers connected with the RBPF is that this adviser , which is a company, is regarded as providing governance advice , rather than investment advice to the panel.
- 36 There are two separate individuals who provide investment advice to the ISS one is long standing , appointed in 2013, whilst the second was appointed in 2018 following an application and interview process for an initial two-year period. This process was in the words of one panel member “Robust” . However , there is no record from the ISS as to how the appointment was determined against pre set criteria so that the process can be seen as being transparent. Any future appointment should be made on the basis of a clear and transparent process involving objective criteria in a clear specification which can be evaluated and scored.
- 37 The change to pooling means that the role of the advisers particularly to the ISS has changed. They no longer have responsibility for commenting on individual asset choices but have a purely strategic role. Many LGPS funds use a mix of some of the larger firms to provide governance and strategic advice with or without a further independent adviser. The advantage of the latter is that the firms have a wider range of experience to draw on than may be available from a single adviser . However , the retention of one independent adviser does present a check against the firm. It has been suggested that the advisers should be voting members of the panel/ IWG . My personal view is that members make decisions based on the advice of officers and advisers and that to allow advisers to vote obscures accountability.
- 38 If the above model is accepted, then the role of the separate adviser to the panel would change to cover both investment and governance advice and that of the single independent investment adviser would cover both the Panel and the ISS. Procurement for this should take place during 2020 . it is likely that short term extensions of current providers will be required to enable the procurement process to be completed

In summary the recommendations for the RBPF :

- That the future model of investment advice be one firm and one independent adviser to advice both the ISS and panel and that this advice should be procured and evaluated in a clear and transparent process. Advisers should attend both meetings but not be formal members with voting rights.

Valuing Assets .

- 39 Deloitte who act as external auditors to RBWM and thus to the fund have raised a number of queries with regard to valuations used to prepare the 2018/19 accounts. There were two significant variations between the draft and final accounts which were detailed in the ISA

260 reports on both RBWM's accounts and on the RBPF's accounts. These relate to a longevity swap and the convertible bond under the USA distressed energy investment referred to above. The issues arising will be discussed in turn.

- 40 The longevity swap requires input in terms of valuations from the RBPF's actuary. Deloitte as part of the audit questioned the assumptions used in valuing the longevity swap. These figures are provided by the fund's actuary. On challenge it became apparent that the model used to value the swap had not been updated for the most recently available national mortality tables whereas the model used to produce the standard accounting entries had been updated following discussions with auditors at a national level. Auditors had made it clear that they were expecting accounting models to be updated annually to reflect the most recent changes in national mortality tables. This was an oversight by the actuary. In their defence past practice has only been to update mortality assumptions in both the swap valuation and accounting models every three years and at the same time as reviewing the triennial valuation model to take account of the actual mortality experience of scheme members covered by the swap. They state that revised arrangements are in place to ensure that the swap valuation model is now updated at the same time as the accounting model rather than every three years with the triennial valuation model. In addition, the Council will need to review these assumptions through its proposed enhanced client arrangements, this is suggested in place of the proposal from Deloitte that the Pensions or Corporate overview and scrutiny panel review this figure.
- 41 It should be noted that valuing the longevity swap is not a new issue, although the scale of the error was much greater in 2018/19. The matter had been previously raised in ISA 260 reports since 2011 by the previous auditor KPMG as follows:-
- 2011/12 Audit . Report notes that the Auditors are still waiting to hold discussions with the Funds actuary over the treatment and valuation of the policy in the IAS 19 calculations.
 - 2012/13 Audit. Report identifies that the timing of indexation for inflation of the future payments was miscalculated by half a year. This resulted in an audit adjustment of £8.9 million.
 - 2013/14 Audit . No Isa 260 report readily available on Council's web site
 - 2014/15 Audit . Report notes that the swap is a significant audit risk and that "the contract should be kept under regular review to ensure its valuation and disclosure are in accordance with accounting standards.
 - 2015/16 Audit. Report noted that the methodology used by the actuary had not been updated to reflect the fact the application of accounting standard IFRS 13 (fair value) to local authorities in 2015/16. However, no material difference in valuation was anticipated.
 - 2016/17 Audit. Unadjusted audit difference relating to the swap was reported due to a particular discount rate not being updated since inception . Impact approximately £6 million
 - 2017/18 Audit . Report states that KPMG, using their actuarial specialists, have agreed the appropriateness of the assumptions and the reasonableness of the assumptions.
- 42 The above record illustrates that the valuation of the swap has often been problematic. KPMG each year referred the calculation to their actuarial specialist for verification due to the nature of the swap . It is clear that in addition to checking not only the appropriateness of various variables within the model that RBPF/ RBWM will also need to ensure that any

changes to accounting standards are taken into account particular regard should be taken when IFRS 17 which deals with insurance accounting replaces IFRS 4.

- 43 The situation with regard to the USA distressed energy investment is different. As noted earlier , this investment is quoted on the Singapore markets and as such the Custodian could and did obtain a value based on an assumed market trade price which was used as part of the draft accounts. This bond is still trading and in fact it is understood in 2019/20 that further bonds have been acquired by non LGPS clients in the United Kingdom at par. In the absence of other evidence this would normally be regarded as being the fair value of the bond which could result in the 2019/20 value being closer to the draft 2018/19 figures rather than the final figures which had a significant right down , following a report by KPMG. It should also be noted that another LGPS investor in the fund has valued the bond in their 2018/19 accounts at par and this was accepted by their auditors.
- 44 In early 2019 , the IWG received a confidential report from LPP on four of the illiquid assets which they had concerns over one of which was the USA distressed energy investment. This concern was not communicated to the Custodian by LPP as they had no requirement to do so , it was also not passed on by RBPF to the Custodian . In addition, nothing was mentioned about this to the RBWM accountant responsible for preparing the accounts. This lack of communication is the significant reason why the draft accounts included the initial valuation from the Legacy Custodian. I have already commented on the need for there to be direct communication between the Custodian and LPP acting on behalf of RBPF despite the apparent absence of a contractual relationship to do this. LPP have indicated that for 2019/20 that LPP might assist RBPF in managing their relationship with their custodian and how RBPF/Legacy Custodian value and verify the portfolio but responsibility remains sovereign to RBPF this will need to be part of the discussion suggested between the above parties and Deloitte. Longer term as referred to earlier , RBWM/RBPF will need to try to build standards for reporting including timeliness into the agreement between RBPF and LPP.
- 45 The Audit also threw up a number of other valuation issues which called into question the processes used by LPP and the Custodian . The most recent report on the Custodian's Asset Management arrangements " Description of its Investment Management Services System and on the Suitability of the Design and Operating Effectiveness of its Controls" received by the Council is dated 2017. It is assumed that there has been no significant variation in these since that date. However , these controls do require a degree of informed client input which has been lacking since the Pensions team was Tupe Transferred to LPP and the assumption that LPP would undertake this role on the assets still in Legacy custodianship which has not been the case. It is therefore important that these controls are reintroduced either by utilising LPP or through other means. Due to the shortness of time between now and closing the accounts discussions need to be held with LPP / Custodian/ Deloitte to address the issues raised.
- 46 There are also a number of other detailed issues where LPP have a difference of view to Deloitte , the absence of clear communications between both parties , and in the view of LPP a misunderstanding of LPP's role and that of the Custodian by Deloitte ,has potentially contributed to this list of issues. It is recommended that both parties meet with a representative of RBPF to iron out any differences before work starts on the 2019/20 Audit. This should be part of the wider meeting with the Legacy Custodian.
- 47 Deloitte in the ISA 260 report presented to the Corporate Overview and Scrutiny Panel in November 2019 have stated that the Panel ensure that valuation controls are challenged , understood, and agreed before inclusion of the valuation in the financial statements. At

present the Panel does not have sight of the draft accounts before publication . The requirement for the draft accounts to be approved by the Council or a committee of the Council was removed some years ago. The fact that the Council only has two months, in a non Covid 19 world, to prepare the accounts now is in itself challenging. If the draft accounts were to be presented to the Panel before publication and if adequate time is to be given so that the accounts are not presented as a late item, the time available to produce the accounts will be reduced by at least 20%. This is regarded as being extremely problematic. It is also doubtful whether, due to the specialist nature of some of the valuations whether the Corporate Overview and Scrutiny Panel could add the significant level of rigour in checking intimated by the ISA 260 and from further comments received from Deloitte post audit. It is recommended that rather than reporting the draft accounts to the Corporate Overview and Scrutiny Panel , that revised internal control procedures are implemented as outlined in this review involving LPP/ Custodian/RBPF/RBWM.

- 48 It is noted that despite having oversight of the RBPF on behalf of the Council that the audited accounts and ISA 260 are not currently reported to the Pensions Panel. Since 2008 , the Pensions fund has been subject to a separate audit . The accounts of the fund should be reported to the Pension Panel as part of Pension Fund annual report, but they do not at present receive the Auditors report although they appear to have done in the past. Practise varies between Administering Authority's, but it seems sensible that the Pension Panel should receive the RBPF Auditor's report in the future.
- 49 With regard to the valuation and reporting process , the review would make the following recommendations to the RBPF.
- That with regard to the longevity Swap that RBPF put in place arrangements to review the assumptions used by the Actuary in calculating the value of the swap. In addition, it will need to review the application of any change in accounting standards.
 - With regard to other illiquid or non-market assets that revised arrangements be put in place involving the custodian , Deloitte LPP, RBWM and RBPF.
 - That RBPF arranges a meeting with LPP and Deloitte to ensure that responsibilities are clear for the 2019/20 Audit. This could be held at the same time as the meeting above.
 - That the Pension Panel receives the external Audit report in future in respect of the RBPF.

Concluding thoughts.

- 50 One theme that re-occurs throughout the review is the historic disconnect between the RBPF and the rest of the RBWM. Reading the reports , noting some of the actions and even looking at how the recent changes to the IWG have been determined show that officers and those involved in the RBPF and the Council itself have assumed that at best the RBPF is a semi-autonomous body and not a full part of the Council . However , in law that is not the case as the Administering Authority RBWM have ,as the transfer order states ,responsibility for the assets and liabilities of the fund. Over the past three years apart from being referred to in constitutional reviews the Council has not received a single report about the Pension Fund. This is perhaps symptomatic of the disconnect that exists. The situation needs to be rectified with the Council taking ownership of the fund both in deed ,as well as nominal title. The Council should consider making it a requirement for the Pension panel to report annually to the Council on the work of the fund. RBPF is required to produce an annual report , and a summary of this could form the basis of the annual report to Council.

- 51 The move to pooling appears to have been focused purely on the transfer of investment responsibilities to LPP but with no serious pre thought as to how any residual functions would be managed by the Council , including the management of legacy illiquid assets, the relationship with the custodian and how the ongoing relationship with LPP would be managed. This is probably the key reason as to why the issues which have now been disclosed following the 2018/19 Audit of accounts occurred . Hindsight is as always wonderful ,but it is surprising that no consideration was given in the lead up to June 2018 as to how these issues would be managed. This needs to be rectified to ensure that there is limited opportunity for a repetition of events.
- 52 Finally ,I would like to thank all parties who assisted the review and for the frank exchange of views and providing detailed background often at speed.

Chris Buss

Original March 2020

Reviewed and Revised July 2020

Terms of Reference

Review of the governance arrangements in relation to investments operated by the Royal Borough of Windsor and Maidenhead in its role as the administering authority of the Royal Berkshire pension fund.

1. Background

The Berkshire Pension Fund is in a unique position as result of the decision to enter into an Advisory and Management Agreement (AMA) with Local Pensions Partnership (Investments) Limited (LPPI) thereby transferring total management of its assets to LPPI. Other pools operate very differently with the Fund Managers at each of the constituent administering authorities working collaboratively to identify the benefits of pooling their investments together. These pools thereby retain investment expertise at each of the Pension Funds which is not the case in Berkshire.

Prior to 1 June 2018, RBWM employed a small number of staff ('the investment team') who operated in the investment (finance) section of the Pension Fund. This included the Pension Fund Manager, an Investment Manager, an Equity Manager and an Investment Administration Manager. From 1 June 2018 RBWM entered into an AMA with the LPPI with the agreement of the Berkshire Pension Fund Panel and Advisory Panel. The Pension Fund Manager was made redundant on 31 May 2018 (and has subsequently passed away) with the other three investment staff TUPE transferring to LPPI on 1 June 2018. Currently, only the former Investment Administration Manager remains employed by LPPI. As a result of the AMA, LPPI became the Investment Manager for all of the Berkshire Pension Fund's assets with RBWM, as the Administering Authority (i.e. the Berkshire Pension Fund Panel), retaining responsibility for the Investment Strategy of the Fund, for the allocation of Fund assets within LPPI's eight investment 'buckets' and for monitoring the performance of LPPI who bring quarterly reports to meetings of the Investment Group and Pension Panels.

The council's auditors, Deloitte, have highlighted concerns in their ISA 260 report as part of their audit of the pension funds 2018/19 account in respect of the system of governance and internal control in place to oversee the Royal County of Berkshire Pension Fund investments. They see significant risks in the arrangements for planning finances effectively.

2. Requirements

The council therefore require an independent review of the governance arrangements in its role as the administering authority of the Royal Berkshire pension fund. This should include but is not limited to investment decisions and the management and operation of investments made. This to be undertaken in conjunction with CIPFA who are supporting the council improve its overall financial governance arrangements by a suitably qualified individual with extensive knowledge and experience of managing a local authority pension fund.

The review will in particular investigate the arrangements concerning an investment into a \$50 million bond and how the council arranges its statutory duties with regard to investments, as set out in the LGPS regulations 2013 and any guidance issued subsequent to those regulations.

The findings and recommendations from the review will be issued to the Managing Director and Director of Resources of RBWM. It will then be reported to the Berkshire Pension Fund Panel and the council's Corporate Overview and Scrutiny panel in May 2020 and will form part of the council's response to the Deloitte ISA 260. The recommendations will be included in the council's Annual Governance statement for 2019/20. Prior to publication a draft report will be provided to and a discussion held with the council's external auditors to ensure it covers all of their concerns.

A clear intention of the report is to address the findings and recommendations raised by external audit as part of their 2018/19 reporting:

- A review is performed of the arrangements around pension asset investment decision making, monitoring and reporting of the valuation investments; and that this should include a retrospective review of the arrangements with respect to the specific assets that were adjusted significantly as a result of the audit to identify the lessons that can be learned and to embed this learning into the new arrangements. We would also expect this to include consideration of the arrangements around declarations of interest, segregation of duties, appointment of directors to companies in which the Fund has invested, due diligence on and authorisation of investments, involvement of specialist advisors, governance and monitoring procedures, and valuation controls.
- The Fund reviews the terms and conditions of its relationship with all investment service providers and seeks assurance that controls are place to ensure that the most recent audited financial statements of each fund, along with the regular capital valuation statements and any evidence of any capital transactions are received and regularly reviewed in a timely fashion.
- The valuations provided by the actuary are reviewed and that the assumptions are challenged, understood, and agreed before inclusion of the valuation in the financial statements.
- The valuation of all bespoke investments is understood by the investment manager and that controls are implemented to ensure an appropriate challenge is made of valuations received from any service organisation.
- The outcome from these reviews should be reported to both the scrutiny committee and the pension panel.”
- We would also expect the review to look at the contractual arrangement with LPP and the controls in place at the authority to understand that activity of LPP and how the authority can gain assurance over the controls in place at LPP, for example through a service auditor report.

- We noted weaknesses in the controls in place around challenging the valuations and the performance of funds. Given the difficulties in obtaining information for the purposes of our audit, we noted that it appears that there were inadequate controls to ensure that valuations are challenged, and that investment existence is checked as a standard practice. We would expect the review commissioned by the authority to assess the adequacy of controls in place in this area and make recommendations for the design and implementation of appropriate controls.

A draft report is required by 8th March 2020 in order that it can be reviewed by the Council prior to the start of the new financial year.

4. CLIENT RESPONSIBILITIES & OBLIGATIONS

- 4.1 The Client shall at all times retain sole responsibility for, and full and sole discretion in respect of, the following matters:
- 4.1.1 the level of risk appetite for the Fund;
 - 4.1.2 the Return Objectives;
 - 4.1.3 the Strategic Asset Allocation;
 - 4.1.4 the Funding Strategy Statement;
 - 4.1.5 the Investment Strategy Statement;
 - 4.1.6 the Triennial Valuation, including setting of contributions; and
 - 4.1.7 decisions relating to the Longevity Insurance Contract.
- 4.2 Without limitation to Clause 4.1, in order to enable LPP I to discharge its obligations under this Agreement (including but not limited to those set out under Clause 9), the Client shall take such actions as are necessary and/or reasonably requested by LPP I and provide or procure the provision of:
- 4.2.1 the information outlined in Clause 4.1;
 - 4.2.2 monthly Legacy Asset data;
 - 4.2.3 monthly cashflow data covering payments and cash receipts in respect of the Fund¹;
 - 4.2.4 monthly Investment data summary, showing final net asset value of the Fund split by asset class; and
 - 4.2.5 such other information, documents and data provided to the Client by a third party including monthly solvency reporting from the Fund actuary.

5. TRANSITION ARRANGEMENTS

- 5.1 Subject always to acting in the best interests of its clients, LPP I shall use all reasonable efforts to transition substantially all of the Portfolio to In-House Funds during the Transition Period. This transition will not necessarily be in-specie.
- 5.2 During the Transition Period:

¹ Note to LPP I: RBWM is happy with this in principle but will need to confirm with its custodian that it will be able to provide all of this information. Please confirm