

INTERNAL AUDIT REPORT

Pension Fund 2019/20

19th February 2020

Number of issues	
Medium	2
Low	2

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Audit information

Fieldwork started	05 December 2019
Fieldwork completed	31 January 2020
Draft report issued	19 th February 2020
Auditor	Lakshmi Lal
Audit Manager	Colin Garland

EXECUTIVE SUMMARY

Introduction and background

Brent Council is the Administering Authority of the Brent Pension Fund (the Fund) and administers the Local Government Pension Scheme (LGPS) on behalf of its participating employers. There were 36 employer organisations with active members within the Brent Pension Fund at 31 March 2019.

The Pension Fund Sub-Committee (PFSC) is responsible for the strategic management of the assets of the Fund and the administration of benefits. The sub-committee meets on a quarterly basis. In addition, the Pension Board (the Board) is in place to provide a scrutiny function to the work of the Council's Pension Fund Sub-Committee. It does not have decision-making powers but its purpose is to provide an oversight role in the administration and governance of the Pension Fund. Its remit therefore covers both pension administration and investment.

The London Collective Investment Vehicle (LCIV) is a designated asset pool for all London boroughs. Current Ministry of Housing Communities and Local Government (MHCLG) guidance suggests that all new investments should be made with the pool.

The Brent Pension Fund has the following investments with the London CIV: Emerging Market equities (through JP Morgan), Diversified Growth Funds (Baillie Gifford/Ruffer) and Multi Asset Credit (CQS). Additionally, the Fund's passive equity investments through Legal and General and Gilts through Blackrock are arranged through the LCIV's negotiated mandate where the Fund benefits from lower negotiated fees.

Objective

The objective of this audit was to provide assurance on the effectiveness and robustness of the Council's arrangements in regards to current investments, strategic asset allocation and compliance with MHCLG regulations.

Scope

To provide assurance over the following sub-processes and control objectives. The audit focused on key controls in place in relation to the sub-processes listed below, to mitigate the potential risks:

- Governance;
- Governance compliance statement;
- Risk management;
- Investments;
- Monitoring;
- Environmental, social and governance factors;
- Independent Advisor, and

- Policies.

Summary of findings

All the scope areas were examined during the audit. Internal audit has identified a number of examples of good practice, in particular:

- The comprehensive governance compliance statement is included within the Brent Pension Fund Annual report and accounts 2018/19. It shows how Brent Council as the Administering Authority of the Brent Pension Fund complies with guidance on the governance of the Local Government Pension Scheme (LGPS) issued by the Secretary of State for Communities and Local Government in accordance with the Local Government Pension Scheme (Administration) Regulations 2008;
- The Fund has clear investment beliefs and funding principles embedded into the consideration of new investments;
- Asset diversification is a consideration for the sub-committee and investment advisors to ensure that not 'all eggs are in one basket'. For example, in November 2018, the Fund's regional listed equity allocation had a notable bias toward UK equities and no exposure to emerging markets. In order to gain exposure to returns generated in emerging markets, as well as considering diversification as one of the key investment beliefs of the Fund, there was a full divestment from Henderson's UK Small Cap and an initial allocation to Henderson's Emerging Markets equity fund by February 2019, and
- There is a comprehensive Pension Fund risk register in place, which included nine overarching risks. The 'risk register' is a standing item on the Pension Board's agenda.

There were two medium and two low risk issues identified which are summarised below. Further details of each of the issues are set out in the detailed findings section of this report:

Medium risk:

- The Terms of Reference for the PFSC is out of date and there are vacant posts within the two governing bodies;
- Absence of a clear skills matrix for members of both PFSC and Pension Board (This issue also contains an advisory finding about the selection and suitability standards of the members of the governing bodies), and

Low risk:

- Insufficient monitoring arrangements to oversee the administration of LCIV.
- Absence of investments in passive trackers that exclusively follow Environmental, Social and Governance (ESG) indexes.

Follow up

Agreed management actions will be followed up to ensure the actions have been implemented and are operating effectively.

We would like to thank all those who were involved in and contributed to this audit.



DETAILED FINDINGS – MEDIUM RISK ISSUES

1. Governance

Issue

PFSC

In May 2019, the General Purposes Committee appointed seven Councillors and one non-voting co-optee from Unison, to the PFSC. The Terms of Reference for the PFSC state that the governing body should comprise of '*7 councillors and 2 non-voting co-opted members from the College of North West London and Brent Care at Home*'.

We confirmed that the Terms of Reference are outdated and do not reflect the current composition of the PFSC. Both College of North West London and Brent Care at Home opted out of the Brent Pension Fund in excess of two years ago.

Furthermore, the PFSC currently consists of only six Councillors. The post for one full member (Labour party) of the Brent PFSC has been vacant since July 2019.

Pension Board

There is currently a vacant post of 'non-Brent Council employer member' within the Pension Board. Management informed us that a new member is expected to be appointed prior to the upcoming Board meeting in March 2020.

Risk exposure

If the governing bodies (PFSC and Board) do not have adequate members to oversee the funding and administration of the pension fund, then this could result in unethical investments that do not provide desirable rates of returns.

Recommendations

The Fund should ensure that:

- The Terms of Reference for PFSB is updated to reflect the current membership composition, in line with appointments made by the General Purpose Committee, and
- Suitable members are promptly appointed to the following vacant positions:
 - Labour party Councillor- PFSC, and
 - Non-Brent Council Employer Member- Pension Board.

Management action plan

Agreed action	Action owner	Due date
Agreed – management will ensure that Terms of Reference for PFSB are updated to reflect the current membership composition and that suitable members are appointed to the vacant positions as soon as possible.	Ravinder Jassar Head of Finance	30 June 2020

2. Suitability standards and skills matrix

Issue

Suitability standards

The General Purpose Committee determines the appointments to the PFSC and Board to ensure that there is adequate political representation in each governing body.

Membership should be subject to minimum suitability standards, such as “fit and proper” criteria in order to ensure a high level of integrity, competence, experience and professionalism in the governance of the pension fund. Causes of automatic disqualification include conviction for fraud, theft or other criminal offences, and gross mismanagement of a pension or other fund that led to significant civil penalties, and, in some cases, personal bankruptcy.

Membership of the PFSC and Board is not subject to minimum suitability (or non-suitability) standards.

No specific recommendation has been raised in this report in respect of the suitability standards as this function is administered by the General Purpose Committee (GPC) and thus, is outside the remit of the Pension Fund Team.

This is therefore an advisory finding, to be considered by the GPC and Head of Committee Services.

Skills matrix and training

Ideally, governing bodies should collectively have the necessary skills and knowledge to oversee all the functions performed by a pension fund, and to monitor those delegates and advisors to whom such functions have been delegated.

Each member of the two governing bodies should contribute to a balanced set of skills and knowledge that enables the PFSC/Board to execute successfully its obligations.

The skills, behaviours, knowledge and understanding of the PFSC/Board members are not currently assessed. This could be done using a skills matrix to identify strengths and any gaps. However, there is no matrix or similar mechanism, currently in place.

Training plans are therefore not designed specifically to address any skill or knowledge gaps identified.

Risk exposure

If there are no suitability standards in place for the members within the sub-committee, then there is a risk that unsuitable members govern The Fund.

If members of the PFSC and Board do not have the appropriate collective skill set to oversee the funding and administration of the pension fund, this could result in ill-advised investments that do not provide desirable rates of return.

If the PFSC does not identify and offer training opportunities in line with any skill gaps identified, then this could result in committee members not being conversant with the details of the scheme and therefore, having a lack of relevant knowledge.

Recommendations

The Fund should ensure that:

- An annual skills inventory is undertaken (via interviews/questionnaires) based on the matrix to identify strengths and any skills gaps of the existing sub-committee/ Board members. Any skill gaps identified should be included within a training plan for the following year.

Management action plan

Agreed action	Action owner	Due date
Agreed. A knowledge/skills assessment will be undertaken in order to develop a formal training plan.	Ravinder Jassar Head of Finance	30 June 2020

DETAILED FINDINGS – LOW RISK ISSUES

3. Monitoring of the LCIV

Issue

Quarterly investment reports provided by LCIV include an ESG summary of each of the funds invested by the Brent Pension Fund.

LCIV underwent a Strategic (ESG) Stock Take by an independent consultant in November, 2019. This resulted in numerous recommendations aiming to ensure that LCIV provides integrated and value added responsible investment and ESG services to its Local Authorities.

Implementation of the recommendations should ensure that LCIV improve their reporting and communication on ESG, thereby providing greater transparency and understanding on fund manager selection, fund manager investment processes, risk management and fund manager monitoring.

Quarterly face-to-face sessions and monthly phone calls between LCIV and the Fund were intended to enable sufficient monitoring and oversight of LCIV and investments. However, these sessions and calls have not occurred in the past few months.

Audit therefore consider that additional steps are required to obtain assurance that the LCIV is appropriately implementing all the recommendations from the Stock Take report.

Risk exposure

If the PFSC does not oversee the administration of LCIV on an on-going basis, there is a risk that the recommendations from the Stock Take Pool may not be fully implemented.

If there are insufficient arrangements (such as regular reviews) in place, there is a risk that ESG issues are not considered whilst undertaking acquisition, retention and realisation of investments.

Recommendations

The Fund should ensure that:

- Regular one-to-one sessions are in place with LCIV to facilitate sufficient monitoring and oversight. In particular, the progression in implementing recommendations from the ESG Stock Take report, and
- Any concerns resulting from the LCIV ESG reporting should be communicated during one-to-one sessions and included in an action plan to ensure improvement.

Management action plan

Agreed action	Action owner	Due date
The Fund aims to maintain regular contact with London CIV to enable sufficient monitoring of all aspects of the Fund's investment related activity including fund performance, risk management and ESG related issues. Due to staffing changes at London CIV, these meetings have not occurred at the frequency that the Fund would prefer in recent months however the Fund continues to engage with London CIV through other means including quarterly investment forums, attendance at workshops and any meetings arranged related to specific issues.	Ravinder Jassar Head of Finance	Implemented

4. Passively managed investments

Issue

The Fund has UK and Global equity investments through Legal and General Investment Managers (LGIM). These investments are passively managed and aim to replicate the performance of the FTSE All-Share/World indexes.

Although passive funds are cheaper and less complex than actively managed funds, a feature of funds such as FTSE All-Share is that the Brent Pension Fund cannot select which assets are held. This increases the likelihood that the Fund invests in companies that do not align with Brent's investment beliefs surrounding ESG factors.

As part of Brent Pension Fund's 2019/20 investment plan, there will be consideration of other forms of indexation such as low carbon strategies.

Investment Managers now offer investments in funds that exclusively track ESG indexes (one that consists only of stocks with the best ESG profiles). For example, LGIM offers Future World ESG Developed Index Fund, which aims to provide a combination of growth and income by tracking the performance of the Solactive L&G ESG Developed Index. This fund provides exposure to global developed-market equities while integrating ESG factors and as a result, does not hold 'pure' coal miners, manufacturers of controversial weapons and perennial offenders of the UN Global Compact.

Alternatively, LGIM also offers investments in Future World Climate Change Equity Factors Index Fund, which replicates the performance of the FTSE All-World ex CW Climate Balanced Factor Index. The fund targets better risk-adjusted equity returns than a traditional index strategy by incorporating 'factors' into index design, while also seeking to address the investment risks and opportunities associated with climate change.

Risk exposure

If the Fund's passive investments invest in companies that do not consider ESG factors, this could give rise to reputational risks to Brent's Pension Fund.

Recommendations

The Fund should consider:

- The benefits and implications (costs, risk appetite, long-term returns) of investing in passive funds that track exclusive ESG indexes.
- Investing in funds that track ESG/climate change indexes, if it aligns with the Pension Fund's funding and investment principles.

Management action plan

Agreed action	Action owner	Due date
The recommendations are agreed and have already been implemented. The pensions sub committee on 25 February 2020 considered a range of low carbon equity passive funds and agreed an investment, in line with the revised investment strategy.	Ravinder Jassar Head of Finance	Implemented

APPENDIX 1 – Distribution list

Shazia Hussain	Assistant Chief Executive
Debra Norman	Head of Legal, HR, Audit and Investigations
Minesh Patel	Finance Director
Ravinder Jassar	Head of Finance
Katie Smith	Head of Committee Services
Sawan Shah	Senior Finance Analyst
Saagar Raithatha	Finance Analyst
Grant Thornton	External Auditor

APPENDIX 2 – Basis of Classifications

Individual Finding Ratings

Critical

A finding that could have a:

- Critical impact on operational performance; or
- Critical monetary or financial statement impact; or
- Critical breach in laws and regulations that could result in material fines or consequences; or
- Critical impact on the reputation or brand of the organisation which could threaten its future viability.

High

A finding that could have a:

- Significant impact on operational performance; or
- Significant monetary or financial statement impact; or
- Significant breach in laws and regulations resulting in significant fines and consequences; or
- Significant impact on the reputation or brand of the organisation.

Medium

A finding that could have a:

- Moderate impact on operational; or
- Moderate monetary or financial statement impact; or
- Moderate breach in laws and regulations resulting in fines and consequences; or
- Moderate impact on the reputation or brand of the organisation.

Low

A finding that could have a:

- Minor impact on the organisation's operational performance; or
- Minor monetary or financial statement impact; or
- Minor breach in laws and regulations with limited consequences; or
- Minor impact on the reputation of the organisation.

Advisory

A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.