

Central Bedfordshire Council

AUDIT COMMITTEE

12 January 2015

LOCAL GOVERNMENT PENSION SCHEME UPDATE

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Purpose of this report.

The purpose of the report is to advise the Committee on the administration and development of the Local Government Pension Scheme. A similar report is made to the General Purposes Committee. The reports have been prepared at the request of both Committees because of the Council's financial obligations in respect of the LGPS and the ongoing reform of public sector pension arrangements.

RECOMMENDATION

The Committee is asked to note the report.

Overview and Scrutiny Comments/Recommendations

1. This report is not scheduled to be considered by Overview and Scrutiny as the Audit Committee provides independent scrutiny of the Authority's financial performance.

Background

2. The Local Government Pension Scheme (LGPS) in England and Wales is a funded public sector pension scheme with approximately 4.6 million members. The regulations for the scheme are determined by parliament and developed by the Department of Communities and Local Government. The scheme is administered locally for participating employers by eighty nine funds across England and Wales.
3. The Bedfordshire Pension Fund is administered by Bedford Borough Council, who is responsible for the pensions of Local Government employees across Bedfordshire, including Luton Borough Council and Central Bedfordshire Council.

4. Participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services such as academy schools, contractors, housing associations and charities.
5. Currently in excess of 130 scheme employers participate in the Bedfordshire LGPS. The Bedfordshire scheme membership numbers at March 2013 and 2014 are shown in Table 1. Following a number of years where active membership had declined the recent introduction of auto enrolment has contributed to an increase in active members for the Fund as a whole.

6. **Table 1 LGPS Bedfordshire and CBC Membership at 31/3/13 and 31/3/14**

| | Fund | Fund | CBC | CBC |
|-------------------|----------------------|----------------------|----------------------|----------------------|
| | 31 March 2013 | 31 March 2014 | 31 March 2013 | 31 March 2014 |
| Active | 17,442 | 18,766 | 3,975 | 4,025 |
| Deferred | 21,142 | 22,821 | 6,755 | 7,144 |
| Pensioners | 13,158 | 13,841 | 4,131 | 4,276 |
| | | | | |
| Total | 51,742 | 55,428 | 14,861 | 15,445 |
| | | | | |

7. The LGPS is administered within a statutory and best practice framework. The various administering authorities apply important policies and strategies that are developed and reviewed with independent specialist advice and consultation with participating employers. The main areas are governance arrangements, funding, investment and communication strategies, all of which can be accessed at the Bedfordshire Pension Fund website (www.bedspensionfund.org).
8. The purpose of this report is to highlight recent developments in respect of the LGPS and the Bedfordshire Fund. A report to this Committee in May 2014 detailed the governance of the Bedfordshire LGPS, the results of the 2013 Actuarial valuation, the implementation of the LGPS 2014 and the Fund's investment strategy. This report provides information on the following matters:
 - a. Development of mechanisms for cost capping across Public Service Pension Schemes,
 - b. Implementation of Local Pension Boards, and
 - c. The Fund's asset management

Development of mechanisms for cost capping across Public Service Pension Schemes

9. Reformed pension schemes will be introduced across much of the public sector from April 2015, the latest LGPS was introduced from April 2014. All the public sector schemes will be subject to statutory cost capping mechanisms to ensure that in the future costs to taxpayers do not exceed agreed limits and that risks are more fairly shared between employers and employees. Importantly any pension scheme deficits will not be part of the proposed capping arrangements. In the case of the Local Government Pension Scheme, the employer cost cap will be calculated by a Scheme actuary appointed by the Secretary of State. The national statutory cap for the LGPS will be based on a 2013 model fund valuation in accordance with Treasury Directions. The figure for the statutory cap based on a 2013 Model Fund is not yet published.
10. When the cost cap has been set for the LGPS, at the future triennial actuarial valuations, there will be an allowed margin of 2% of pensionable pay above and below the cap value to deal with small cost changes. Should the 2% margin be breached there will be consultation to allow the responsible authority, scheme managers, employers and members (or their representatives) to agree how employer costs should be brought back to the level of the cap. In the event that agreement is not achieved the Treasury will direct a default adjustment to pension accrual rates.
11. In March 2014 the Treasury published guidance on how pension scheme cost capping would work. Cost caps will not apply to all the pension costs as significant risks will continue to be retained by the employer. Cost increases arising from changes in the discount rate used to value liabilities, actuarial valuation methods or investment performance will fall to the employer. In addition, the past service costs of deferred and pensioner members in any earlier pension schemes will be excluded from the cap mechanism. The caps will only address those changes which relate directly to members, for example life expectancy changes and salary growth. The result of this approach will be that there will be a difference between the actual employer contribution rate paid by employers and the rate that is controlled by the cap.
12. Any cost adjustment may be achieved by a change in future benefit accrual, change in member contributions or some other adjustment. There is no intention to make changes to accrued benefits. HM Treasury consent will be required to any change.
13. In addition to the Treasury employer cost cap process, provision is also to be made for an internal cost management process agreed between Government, the Local Government Association and local government trade unions. Unlike the Treasury's employer cost cap process which

will monitor changes in the value of benefits in the new Scheme over time, the aim of the internal process is to stabilise the actual contribution rates paid by employers and members in respect of the new Scheme within an overall target cost of 19.5% of pensionable pay with the target yield from scheme members' contributions being one third of the overall cost (i.e. currently 6.5%). The local model will apply some different assumptions to the Treasury model e.g. mortality tables and take up of the various membership options.

14. As with the statutory cost cap, certain drivers of scheme costs will not affect the cost control mechanism run the by the National Local Government Scheme Advisory Board. In addition to existing past service effects and changes in financial assumptions, risk associated with investment performance will also be excluded from both the statutory cost cap and the Board's cost control mechanism. Investment risk will instead be dealt with via improved governance.
15. Whilst the statutory cap takes precedence, the LGPS cost control process is designed to initiate consultation between stakeholders when indicated variations in future costs are below the 2% national limit.
16. The Department of Communities and Local Government is currently consulting on detailed regulations to implement the statutory cost capping mechanism for the LGPS as well as the additional cost control arrangement.

Implementation of Local Pension Boards

17. The LGPS has been subject to significant changes over recent years as central government strives to ensure that public sector pension schemes provide value for money. This objective is in line with the Council's own value for money priority.
18. Significant changes are being introduced to the governance of the LGPS from April 2015 with the creation, at a national level, of a Scheme Advisory Board to advise the Responsible Authority for the Scheme (the Secretary of State for Communities and Local Government). At a local Fund level Bedford Borough Council, the Administering Authority, must create a Pension Board to assist it in its role as the Scheme Manager of the Fund. The purpose of the Pension Board is to secure compliance with regulations and to ensure the effective and efficient governance and administration of the LGPS. The Pension Regulator's powers have also been extended to cover some aspects of public service pension schemes, including the LGPS.
19. By 1 April 2015, the Administering Authority must have approved the establishment of the Local Pension Board and its composition and also the terms of reference, in accordance with its constitution. The creation of new Local Pension Boards does not change the core role of the Administering Authority or the way it delegates its pension functions. It

is anticipated that Bedford Borough Council will consider the options available in respect of the creation of a local Pension Board when the current consultation on the relevant draft regulations and draft statutory guidance ends on 21 November 2014. Bedford Borough Council plan to consult stakeholders on any draft Pensions Board proposals and this could even take place before any final regulations are published.

20. A Local Pension Board must include an equal number of employer and member representatives with a minimum requirement of no less than four in total. No officer or councillor of an Administering Authority who is responsible for the discharge of any function under the LGPS Regulations (apart from any function relating to Local Pension Boards or the Scheme Advisory Board) may be a member of a Local Pension Board.
21. All employers and members within a Fund must have equal opportunity to be nominated for the role of employer or member representative through an open and transparent process.
22. The Regulations also allow for the appointment of other members i.e. members who are not there to represent employers or scheme members, for example where an Administering Authority wishes to appoint an independent chairperson to the Local Pension Board.
23. Regulations require that the Administering Authority must ensure that any person it wishes to appoint as an employer or member representative has relevant experience and the capacity to represent the employers or members (as appropriate) of the Fund.
24. Following an initial draft regulations consultation in June 2014 a subsequent consultation commenced 10 October 2014 (due to cease 21 November 2014). The main change between the consultations, following concerns raised by local government, has been to allow elected members to become members of a local Pension Board.
25. The implementation and maintenance of the LGPS governance changes outlined above will require a significant contribution from the local administering authority. The requirement that Pension Board members to have relevant experience may present a challenge

Fund Asset Management

26. The Fund has implemented an investment strategy and benchmark (Table 2) that seeks to provide less volatile returns compared to Funds with a greater weighting to equities. In periods when equity markets are very strong the Fund is likely to underperform the average local authority fund which tends to have greater allocation to equities. Conversely when equity markets are weak the Fund would be expected to outperform the average local authority fund.

27. **Table 2 Fund Asset Allocation Benchmark (SIP 2014)**

| Asset Classes | Benchmark | Allocation Range |
|-----------------------------|------------------|--|
| UK equities | 19% | Range 40%- 60% |
| Global/Overseas equities | 31% | |
| UK Gilts | 4% | Range 13%-33% |
| Absolute Return Bonds | 10% | |
| Corporate Bonds | 4% | |
| Absolute Return Multi Asset | 20% | Range 15%-25% |
| Property | 10% | Range 5%-15% |
| Cash/Opportunistic | 2% | Opportunistic Range 0%-4% Cash Range 0%-10% |
| Total | 100% | |

28. The Fund Administrator reported on the Pension Fund Performance over the three month period ending 30 June 2014 at the Bedford Borough Council Pensions Committee meeting on 15 September 2014. The market value of the Fund and cash holdings as at 30 June 2014 was £1,570.9 million (Table 3) which was an increase of £32.8 million since 31 March 2014. This positive performance had primarily derived from the equities asset class.
29. The Pension Fund investment return for the quarter ending 30 June 2014 was 2.2% which was ahead of the benchmark return of 2.0% and in line with the estimated WM Local Authority average of 2.2%.
30. At its meeting held on 11 March 2014, the Pensions Committee had reviewed the level of cash held and made allocations to rebalance back to benchmark. Allocations were agreed to Property, Emerging Market Equities and Multi-Asset Absolute Return. The latter two had been transacted and were included as part of the current asset allocation. It was noted that the current asset allocation remained consistent with the strategic benchmark.
31. At its meeting held on 17 June 2014 the Committee agreed to restructure its passive bond holdings away from Corporate Bonds. This had been completed in early July 2014 and will be shown in the next quarter's report.
32. The investment objective is subject to the strategy being carried out within acceptable levels of risk. Risk associated with investments is controlled through the diversification between asset classes and Investment Managers. The risk within each portfolio is monitored with the Managers. Benchmark risk is controlled by indexing a proportion of the Fund's assets to passively track appropriate indices. Benchmark

risk is the risk that investments in a particular asset class (i.e. UK equities, overseas equities) do not match the broad market return on that asset class as represented by an appropriate index for that asset class. The Fund's investments at 30 June 2014 are shown in Table 3 overleaf.

33. **Table 3 Bedfordshire Fund Investment Asset classes and values at 30 June 2014**

| Asset class | 30 June-14 | 30 June-14 | Benchmark |
|-----------------------------|-------------------|-------------------|------------------|
| | £M | % | % |
| UK Equities | 307.3 | 19.6 | 19 |
| Overseas Equities | 486.7 | 30.1 | 31 |
| Total Equities | 794.0 | 50.5 | 50 |
| UK Gilts (inc Index Linked) | 68.8 | 4.4 | 4 |
| Corporate Bonds | 83.9 | 5.3 | 4 |
| Absolute return Bonds | 135.5 | 8.6 | 10 |
| Total Bonds | 288.2 | 18.3 | 18 |
| Property – (Indirect)) | 146.0 | 9.3 | 10 |
| Multi Asset Absolute Return | 288.7 | 18.4 | 20 |
| Cash | 54.0 | 3.5 | 2 |
| Total Fund | 1,570.9 | 100 | 100 |

34. During the summer the DCLG consulted on opportunities to deliver cost savings and efficiencies through LGPS Funds investing through Common Investment Vehicles and an increased use of passive investment approaches. The Bedfordshire Fund responded to the consultation stressing the need for transparency across LGPS investments to drive best value. The Fund already invests almost 50% of its assets through passive strategies and invests in a wide range of pooled vehicles. The Pension Committee is supportive of Common Investment Vehicles where the governance is transparent and where they address an investment need such as allowing a diversified and cost effective investment in infrastructure.

Corporate Implications

35. The LGPS is an important part of the employment benefit arrangements for approximately 4,000 Council staff and the governance and performance of the scheme merits regular consideration by this Committee.

Legal Implications

36. The LGPS in England and Wales is operated in line with various regulations made by the Secretary of State for Communities and Local Government in exercise of the powers conferred by the Superannuation Act 1972 and the Public Service Pensions Act 2013.

Financial Implications

37. The most recent Bedfordshire LGPS triennial actuarial valuation at 31 March 2013 disclosed Central Bedfordshire Council's liability of £550m compared to assets of £361m. It is planned to address the funding deficit of £189m (36%) over a twenty year period whilst stabilising the overall employer's contribution rate. In the current financial year 2014/15, employer contributions of 14% of pensionable pay are paid to the Bedfordshire Fund (approximately £8m p.a. including schools non-teaching staff) along with an additional lump sum of £6.7m towards the funding deficit.

Equalities Implications

38. There are no equalities implications.

Conclusion and next Steps

39. This is the second update to the Committee in respect of the LGPS arrangements and demonstrates the ongoing activity in respect of reform of public sector pension schemes.

Appendices

None

Background Papers

None