Central Bedfordshire Council

Audit Committee 11 January 2016

LOCAL GOVERNMENT PENSION SCHEME UPDATE

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Purpose of this report

To update the Committee on the governance of the Local Government Pension Scheme (LGPS).

RECOMMENDATION That the Committee 1. Consider and comment upon the issues raised within the report.

Overview and Scrutiny Comments/Recommendations

1. This report is for information only and has not been made to any Overview and Scrutiny Committee. Due to the significant values of assets and liabilities and the importance of the LGPS to the Council this Committee receives regular reports on the governance and performance of the Local Government Pension Scheme.

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.

3. 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 some eighty nine funds across England and Wales.

4. The Bedfordshire Pension Fund, is administered by Bedford Borough Council, which is responsible for the pensions of Local Government employees across Bedfordshire, including Luton Borough Council and Central Bedfordshire Council.

5. 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.

6. At 31 March 2015 there were 137 active and 24 inactive scheme employers participating in the Bedfordshire LGPS. The actual Bedfordshire scheme membership numbers at March 2013 and 2015 are shown in Table 1 overleaf. Following a number of years where active membership had declined the introduction of auto enrolment (whereby the default position for new employees is that they are included in the scheme and have to opt out if they do not wish to be included) has contributed to an increase in active members for the Fund as a whole.

Table 1 LGPS Bedfordshire and CBC Membership at 31/3/13 and 31/3/15

	Fund	**Fund**	**CBC**	**CBC**
	31 March 2013	**31 March 2013**	**31 March 2013**	**31 March 2015**
Active	17,442	19,931	3,975	4,485
Deferred	21,142	24,910	6,755	7.556
Pensioners	13,158	14,281	4,131	4,442
Total	**51,742**	**59,122**	**14,861**	**16,483**

7. The LGPS is administered within a statutory and best practice framework of regulation and governance. The various administering authorities apply important policies and strategies that are developed and reviewed with independent specialist advice and in 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 update the Committee on any changes or proposed changes to the regulations and governance of the scheme that have arisen since the previous report to this Committee and provide information in respect of the latest reported investment performance of the Fund.

Governance and Regulatory Changes

9. The Government has been examining ways to achieve efficiencies and improvements in the management of local government pension funds. A reduction in the number of administering authorities was considered but at the present time this does not appear to be an option that is being pursued by central Government. During 2015 the Chancellor of the Exchequer made announcements in respect of the future arrangements for the administration of the LGPS investments. The Chancellor's expressed aims are to promote, through the pooling of assets, the creation of half a dozen British wealth funds spread across the country to save hundreds of millions in costs, and invest billions in the infrastructure of their regions.

10. The Department for Communities and Local Government (DCLG) in November 2015 launched a consultation on draft regulations that would reform the investment regulations and introduce a power of intervention to allow the Secretary of State to intervene in an authority's investment function should it not bring forward ambitious proposals for pooling. The consultation, revoking and replacing the Management and Investment of Funds Regulations 2009, is open until 19 February 2016 and available at: https://www.gov.uk/government/consultations/revoking-and-replacing-the-local-government-pension-scheme.

11. The DCLG has provided criteria and further guidance that administering authorities must meet to deliver the ambitious proposals for the pooling of assets. Further guidance on suitable collective investment vehicles has also been provided by DCLG and made available to stakeholders. The four criteria, which were designed to be read in conjunction with the supporting guidance are set out below as they appear in the DCLG documentation:

    a. **Asset pool(s) that achieve the benefits of scale:** The 90 administering authorities in England and Wales should collaborate to establish, and invest through asset pools, each with at least £25bn of Scheme assets. The proposals should describe these pools, explain how each administering authority's assets will be allocated among the pools, describe the scale benefits that these arrangements are expected to deliver and explain how those benefits will be realised, measured and reported. Authorities should explain:

        i. The size of their pool(s) once fully operational.
        ii. In keeping with the supporting guidance, any assets they propose to hold outside the pool(s), and the rationale for doing so.
        iii. The type of pool(s) they are participating in, including the legal structure if relevant.

iv. How the pool(s) will operate, the work to be carried out internally and services to be hired from outside.
v. The timetable for establishing the pool(s) and moving their assets into the pool(s). Authorities should explain how they will transparently report progress against that timetable.

b. **Strong governance and decision making:** The proposed governance structure for the pools should:

i. At the local level, provide authorities with assurance that their investments are being managed appropriately by the pool, in line with their stated investment strategy and in the long-term interests of their members;
ii. At the pool level, ensure that risk is adequately assessed and managed, investment implementation decisions are made with a long-term view, and a culture of continuous improvement is adopted.
iii. Authorities should also revisit their internal processes to ensure efficient and effective decision making and risk management, while maintaining appropriate democratic accountability. Authorities should explain:
iv. The governance structure for their pool(s), including the accountability between the pool(s) and elected councillors, and how external scrutiny will be used.
v. The mechanisms by which the authority can hold the pool(s) to account and secure assurance that their investment strategy is being implemented effectively and their investments are being well managed.
vi. Decision making procedures at all stages of investment, and the rationale underpinning this.
vii. The shared objectives for the pool(s), and any policies that are to be agreed between participants.
viii. The resources allocated to the running of the pool(s), including the governance budget, the number of staff needed and the skills and expertise required.
ix. How any environmental, social and corporate governance policies will be handled by the pool(s).
x. How the authorities will act as responsible, long term investors through the pool(s), including how the pool(s) will determine and enact stewardship responsibilities.
xi. How the net performance of each asset class will be reported publically by the pool, to encourage the sharing of data and best practice.

c. **Reduced costs and excellent value for money:** In addition to the fees paid for investment, there are further hidden costs that are difficult to ascertain and so are rarely reported in most pension fund accounts. To identify savings, authorities are expected to take the lead in this area and report the costs they incur more transparently. Proposals should explain how the pool(s) will deliver substantial savings in investment fees, both in the near term and over the next 15 years, while at least maintaining overall investment performance.

d. Active fund management should only be used where it can be shown to deliver value for money, and authorities should report how fees and net performance in each listed asset class compare to a passive index. In addition authorities should consider setting targets for active managers which are focused on achieving risk-adjusted returns over an appropriate long term time period, rather than solely focusing on short term performance comparisons. As part of their proposals, authorities should provide:

    i. A fully transparent assessment of investment costs and fees as at 31 March 2013.
    ii. A fully transparent assessment of current investment costs and fees, prepared on the same basis as 2013 for comparison.
    iii. A detailed estimate of savings over the next 15 years.
    iv. A detailed estimate of implementation costs and when they will arise, including transition costs as assets are migrated into the pool(s), and an explanation of how these costs will be met.
    v. A proposal for reporting transparently against their forecast transition costs and savings, as well as how they will report fees and net performance.

e. **An improved capacity to invest in infrastructure:** Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can improve the capacity and capability to invest in this asset class. Authorities should explain:

    i. The proportion of their fund currently allocated to infrastructure, both directly and through funds, or "fund of funds".
    ii. How they might develop or acquire the capacity and capability to assess infrastructure projects, and reduce costs by managing any subsequent investments directly through the pool(s), rather than existing fund, or "fund of funds" arrangements.
    iii. The proportion of their fund they intend to invest in infrastructure, and their ambition in this area going forward, as well as how they have arrived at that amount.

12. Central Government has set local authorities a challenging agenda and responses are invited by February 2016 with an announcement by the Government of the way forward expected in the spring of 2016. The Bedfordshire LGPS is participating with other Funds in a project to produce options that will meet the specific criteria and form a basis of discussion between the LGPS. Some 40 Funds are involved in the project with data being gathered on a total asset value of £150bn out of a total LGPS asset value of approximately £200bn. There are other initiatives and projects underway involving other LGPS Funds at both a regional and national level.

13. There is a wide range of pooling options and legal investment structures that can be identified and evaluated as to how far they meet the DCLG expectations. As strategic investment decisions are expected to continue to be made by the local LGPS Fund the structure and investment mandates of the available investment pool(s) will be important in determining the degree of detail that can be set and implemented through any local strategy.

14. The Bedford Borough Council Pension Fund Committee met on 5th January 2016 to progress a response to the consultation.

Fund Management

15. The Fund has implemented an investment strategy and benchmark 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 generally has a greater relative allocation to equities. Conversely when equity markets are weak the Fund would be expected to outperform the average local authority fund.

16. At the Bedford Borough Council Pensions Committee meeting on 24th November 2015 the Fund Administrator reported on the Pension Fund Performance over the nine month period ending 30th September 2015. The market value of the Fund and cash holdings as at 30th September 2015 was £1,611.8 million (Table 2). The Fund has decreased by £92.4 million since 31 March 2015 which mainly reflects the significant decline in equity markets that occurred during August 2015.

Table 2 Bedfordshire Fund Investment Asset classes and values at 30 September 2015			
Asset class	**31 Mar-15**	**30 Sept-15**	**Bench mark**
	£M	**%**	**%**
UK Equities	298.4	18.5	19
Overseas Equities	486.2	30.2	31
Total Equities	**784.6**	**48.7**	**50**
Government Bonds	59.3	3.7	
Index Linked Gilts	89.5	5.6	
Absolute return Bonds	161.5	10.0	
Total Bonds	**310.3**	**19.3**	**18**
Property – (Indirect))	175.2	10.9	10
Multi Asset Absolute Return	298.3	18.5	20
Cash	43.4	2.7	2
Total Fund	**1,611.8**	**100**	**100**

17. The Bedfordshire Pension Fund investment return of -3.3% for the quarter ending 30 September 2015 was behind the benchmark return of -0.4% and marginally better than the estimated State Street Local Authority average of -3.5%. Over 12 months the Fund has returned 1.4% compared to a benchmark figure of 3.0% and a State Street Local Authority average of 2.5%. Over three years and five years the Fund has returned an annualised 6.4% and 6.0% which can be compared to respective benchmark returns of 6.6% p.a. and 6.9% p.a.

Actuarial Valuation 2016 and employer reporting

18. Regulations require that every three years the Scheme Actuary conducts an actuarial valuation to determine the level of employers' rates of contribution to the Fund. The next valuation date is 31st March 2016 and preparations for the 2016 Valuation have commenced and the expectation is that it will be extremely challenging for the Fund and its scheme employers. This assessment is based on the March 2015 end of year data returns where delays and validation issues with one payroll provider's returns resulted in the Scheme being unable to issue Annual Benefit Statements to scheme members. The Pensions Regulator has been notified by the Fund of the failure to comply with pension regulations in respect Annual Benefit Statements.

19. The administering authority is currently discussing a timetable with the Actuary and it is expected that, as in previous years, the initial results should be available in September 2016. The success of the timetable will rely heavily on all payroll providers submitting timely, complete and accurate information. The actuary has introduced a data portal which will validate the valuation data as it is loaded which should reduce the overall time on the validation both by Hymans and the Fund. Employers will be reminded regularly between January 2016 and March 2016 of the requirement to provide such data by 30 April 2016. The Annual Employers meeting that will be held in February 2016 will also focus on the issue.

20. An important factor in the employer data issues arising for 2015 was the introduction of the new LGPS 2014 scheme and the need to adapt year end reports to meet the requirement of a new scheme that is now based on Career Average Earnings rather than a scheme member's Final Salary. The Bedford Fund has provided the Council with detailed feedback on the 2015 data submissions and new reports are currently in development.

Council Priorities

21. This report provides information about the Local Government Pension Scheme (LGPS). 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.

Corporate Implications

Legal Implications

22. There are no specific legal implications as this report is made for information purposes. 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

23. There are no specific financial implications as this report is made for information purposes. 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 2015/16, employer contributions of 14% of pensionable pay are paid to the Bedfordshire Fund (approximately £8m p.a. including contributions for schools non-teaching staff) along with an additional lump sum of £7.212m towards the funding deficit.

24. LGPS contributions are a significant proportion of the Council's overall employment costs and as such the governance and performance of the scheme merits regular monitoring by this Committee.

Equalities Implications

25. There are no specific implications for equalities as this report is made for information purposes.

Conclusion

26. The LGPS continues to be subject to considerable change and the current focus relates to the management of investments. There is a significant challenge for the 89 LGPS Funds and their stakeholders to agree investment pooling options that meet the Government's criteria early in 2016. The Fund and its employers also continue to address the operational issues arising from the implementation of the 2014 scheme for LGPS benefits so that the 2016 actuarial valuation can be delivered in September.

Appendices

None

Background Papers

None