Central Bedfordshire Council

AUDIT COMMITTEE Monday, 8 January 2018

Local Government Pension Scheme Update

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Purpose of this report

1. To provide an update on the governance of the Local Government Pension Scheme (LGPS).

RECOMMENDATIONS

The Committee is asked to:

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 5.3 million members. The scheme, which currently invests some £217 Billion in assets, is the largest defined benefit scheme in the UK and one of the largest in the world.

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 ninety one 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 2017 there were 149 active and 10 inactive scheme employers participating in the Bedfordshire LGPS. The actual Bedfordshire scheme membership numbers at March 2013 and 2017 are shown in Table 1 below. 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.

7. The reduction in the numbers of CBC employees since 2013 is due to schools converting to academy status and therefore no longer considered CBC employees. They still remain in the fund totals.

Table 1 LGPS Bedfordshire and CBC Membership at 31/3/13 and 31/3/17

	Fund	**Fund**	**CBC**	**CBC**
	31 March 2013	**31 March 2017**	**31 March 2013**	**31 March 2017**
Active	17,442	21,140	3,948	4,763
Deferred	21,142	29,456	6,755	5,115
Pensioners	13,158	15,538	4,131	1,842
Total	**51,742**	**66,134**	**14,834**	**11,720**

Regulatory and Governance Changes

Border to Coast

8. The creation of pooled investment vehicles for the England and Wales LGPS is progressing and eight pools have submitted business plans to the government. The various pools have been meeting with the Minister for State for Local Government and to date several pools have

been advised to progress further with the implementation of their business plans including the Border to Coast Pension Partnership (BCPP), of which the Bedfordshire Fund is a member. The pool has c£44.3bn of assets (estimate value at 30th June 2017).

9. Border to Coast has now appointed Rachel Elwell as its first Chief Executive. She is an actuary with twenty years experience in pensions. She joins from Royal London. Fiona Miller has been appointed as Chief Operating Officer. She will join in January 2018 from Cumbria County Council where she managed their pension scheme. Chris Hitchin has been appointed an non executive Chairman. He is due to start in March 2018 and is currently the Chief Executive of the Railway pension fund.

10. As at 30th September 2017 all shareholder documentation for BCPP has been completed, two Joint Committee meetings have been held in June and October 2017, and BCPP Limited has been incorporated as a limited company.

11. There will be a dedicated Infrastructure sub-fund available to partner funds once BCPP is fully operational. This will invest in a broad range of infrastructure investments with suitable sector and geographic diversification. The intention is that a part of this offering may be satisfied by the solution identified within the Infrastructure Cross Pool Sub-Group.

12. To ensure that BCPP is an active participant in any cross pool solution it chairs the Cross Pool Infrastructure sub-group and also has representation from senior investment professionals. The group continues to make steady progress towards the creation of an effective solution. The group continues to develop its thinking by learning from solutions currently being developed within the LGPS and through wider engagement with industry participants, to ensure that BCPP can access Infrastructure investments in the most effective manner.

Cap on Exit payments

13. The Enterprise Act 2016 will limit the value of exit payments an employee can receive from a public sector employer to £95,000. The exit payment cap will include actuarial strain costs which are those costs paid by the employer to the Pension Fund, and the Act contains amendments to the LGPS Regulations so that members benefits can be amended to help meet the exit payment cap.

14. A statutory instrument has been made which brought s41 of the Enterprise Act 2016 into force on 1st February 2017. Section 41 allows the Secretary of State to issue regulations capping public sector exit payments (including pay in lieu or notice, redundancy and ex gratia payments) to £95,000. Whilst this is only the power to bring in the regulations, it was anticipated that they may be brought into force in

March/ April 2017 although this seems to have been pushed back and is now expected early in 2018.

15. We are also waiting for provisions which provide for clawback of certain public sector exit payments when certain individuals return to work in the public sector within 12 months.

Markets in Financial Instruments Directive II (MIFID II)

16. The Markets in Financial Instruments Directive is the EU legislation that regulates firms who provide services to clients linked to ‘financial instruments’ (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded.

17. This directive comes into force on 3 January 2018. The Fund will need to opt up to Professional status to maintain its current investments and advice and a process has already started to meet the deadline. At the time of writing the Fund has been confirmed as opting up to professional status for 9 of the 11 External Fund Managers.

Actuarial Valuation and Employer Contributions

18. The actuarial review was covered in detail in the report to the Audit Committee in January 2017.

CBC Certified Employer Contribution Rates

19. The CBC employer contribution is stated below including the annual lump sum for deficit recovery.

Table 2 – CBC Certified Employer Contribution Rates

Year	Future Current Service Rate % of pay	Lump Sum for deficit recovery £M	Total Rate %
2014/15	14.0	6.662	24.4
2015/16	14.0	7.212	24.9
2016/17	14.0	7.450	24.9
2017/18	**16.9**	**5.903**	**24.2**
2018/19	**16.9**	**7.073**	**25.2**
2020/21	**16.9**	**8.296**	**26.5**

20. The increase in the current cost of accrual (current service rate) from 14% of pay to 16.9% reflects the change in discount rate and the actual take up of the 50:50 membership option which has, in common with the LGPS as a whole, been much less than was originally assumed. The increase in contribution rates continues to be stabilised for the majority of public sector employers.

21. The outcome of the initial modelling exercise suggested that the contributions would need to increase by more than the 0.5% p.a. steps that had applied in previous years. Further modelling took place to assess the appropriateness of a funding strategy for the councils assuming larger increases of +1% of pay p.a. The certified rates for the Council have been based on the later modelling results which generated an appropriate likelihood of achieving a fully funded position over a 20 year period.

22. CBC must pay the lump sum deficit recovery to the pension fund annually. This sum assumes a contribution from maintained schools. As schools convert to Academies, they no longer contribute to the CBC total and so the share of the element that CBC pays increases accordingly.

23. On conversion, the Academy pays toward its own deficit, but the total amount chargeable to CBC is fixed until the next triennial valuation. Effectively CBC overpays until the reset which is adjusted at that point.

24. Eight schools have or are planning to convert in 2017/18 and so CBC faces a budget pressure of £299K in 2018/19 due to reduced schools contributions to CBC. This is reflected in the 2018/19 Medium Term Financial Plan.

25. There are two cost capping mechanisms in place for the LGPS which may lead to changes to the accrual rate or contribution rates from 2019. The caps only apply to future service costs and are independent of investment market conditions. Work on the two cost caps is already underway separately for the Scheme Advisory Board and HM Treasury.

Fund Management

Pension Fund Performance to 30 September 2017

26. The Fund value ended the quarter higher having experienced additional positive equity performance in sterling terms with some regional markets hitting all-time highs during the quarter. Property and Corporate bond asset classes returned a positive return with the fixed interest market seeing some yield increases which led to a fall in value.

27. The market value of the Fund and cash holdings as at 30 September 2017 was £2,120.1 million, an increase of £30.5 million from £2,089.6 million as at 30 June 2017 and an increase of £392.7 million since the 31 March 2016 (the date of the last triennial valuation) value of £1,727.4 million. The positive performance since the triennial valuation has primarily come from the equities asset class.

28. The Pension Fund net investment return (total value of net investments/divestments) for the quarter ending 30 September 2017 was 1.2% which is behind its benchmark return of 1.9%.

29. The performance for the preceding 12 months was 8.9% which is ahead the benchmark of 7.7%.

30. The performance over the preceding 3 year period was 8.7% per annum (pa) which is ahead of the benchmark return of 6.7% pa.

31. The performance over the preceding 5 year period was 8.7% pa which is ahead of the benchmark return of 7.4% pa.

Rebalancing the Investment Portfolio

32. The Fund invests in a range of asset classes to diversify the sources of return and risk factors that it is exposed to e.g. the property allocation and the diversified growth allocations (which themselves have considerable diversification built in). Within asset classes, the Fund's equity allocation has exposure to different regions, sectors, benchmarks and managers.

33. The fund regularly reviews its exposure and where necessary, rebalances the portfolio to achieve the optimum balance of risk and return.

34. During the 2016/17 financial year the value of the Fund increased by £341 million to £2,074 million. The Fund rebalanced its portfolio initially moving £150m from UK Equities and investing in All World Equities in mid June 2016. Furthermore, in March 2017, an additional £50m was then moved from Global Equities and invested in Absolute Return Multi Asset Funds.

35. A further rebalancing exercise was carried out in early July 2017 which resulted in £36m being disinvested from the equity portfolio and the proceeds invested across the Fund's three multi-asset absolute return managers, with £12m being invested in each mandate.

Asset allocation.

Table 3 Bedfordshire Fund Investment Asset classes and values at 30 September 2017			
Asset class	**30 Sept-17**	**30 Sept-17**	**Bench mark**
	£M	**%**	**%**
UK Equities	194.5	9.2	9
Overseas and Global Equities	889.1	41.1	41
Other	(16.6)		
Total Equities	**1067.0**	**51.7**	**50**
Government Bonds	64.6		
Index Linked Gilts	107.0		
Absolute return Bonds	174.0		
Total Bonds	**345.6**	**16.3**	**18**
Property – (Indirect))	192.1	9.1	10
Multi Asset Absolute Return	422.5	19.9	20
Private Equity	1.3	0.1	
Cash	91.6	4.3	2
Total Fund	**2,120.1**	**100**	**100**

Liabilities

36. The Fund monitors its valuation position with a regular report from the Actuary called Navigator. The latest Navigator report shows that the last 18 month period since the Valuation has seen a slight improvement in the funding level of the Pension Fund. The biggest change since the previous Navigator report has been a contribution from the change in yields of £25 million. The liabilities as at 30 September 2017 are estimated at £2,886 million (circa £2,446 million as at 31 March 2016). As such, as at 30 September 2017, the Funding Level is 73.5% (70.8% as at 31 March 2016). The improvement is principally due to the investment performance slightly exceeding the significant fall in real bond yields over the period i.e.; index linked gilts

yielded – 1.48% a reduction as at 30.6.17 from the –0.96% as at 31.3.16 and continues to highlight the current challenging times for funding Pension Funds.

Opportunistic Investments

37. The Fund's investment strategy includes allocations to active managers. In particular, the absolute return managers have flexibility to adapt their asset allocations as they see fit within the parameters of their respective mandates, with a view to generating positive absolute returns irrespective of prevailing market conditions.

38. The Committee also pay close attention to the valuations of asset classes and markets, taking advice from its investment consultant regarding opportunities within markets. Notable examples are the training sessions that the Panel have received on alternative credit assets, with a view to potentially evolving the Fund's bond allocation, and the decision to invest in Standard Life's SOFIII fund.

39. Any appropriate opportunities are then considered in the context of the Fund's overall investment strategy. The Fund's "opportunistic" allocation gives it considerable flexibility to capture any opportunities.

40. The Funds Investment Consultants, Hymans Robertson have advised the Pensions Committee that private debt was currently looking relatively expensive, with the representative from one of our Fund Managers at the last Pensions Panel meeting also having indicated that now was not the right time to invest in private debt. However private debt was considered a better long term investment than gilts as the interest rate was floating so they might become more attractive in the future.

41. The Fund is able to invest up to 2% in Opportunistic Investments, 1% of which had been allocated to the Standard Life SOF III.

42. The Fund Administrator commented that there was still an opportunity for a further 1% opportunistic investment, which would be in the region of £20 million.

43. Two Fund managers have been invited to a meeting in January 2018 to give a presentation, with a view to give a decision on whether to proceed with this type of investment.

Council Priorities

44. This report provides information about the Local Government Pension (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

45. 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 and Risk Implications

46. There are no specific financial implications as this report is made for information purposes.

47. 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

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

Conclusion and next Steps

49. The LGPS continues to be subject to considerable change and the current focus relates to the management of investments. The Fund and its employers also continue to address the operational issues arising from the implementation of the 2014 scheme for LGPS benefits.

Appendices

None

Background Papers

None