

## Central Bedfordshire Council

AUDIT COMMITTEE

Monday, 30 July 2018

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### 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. The reduction in the numbers of CBC employees since 2013 is due in part to schools converting to academy status and therefore they are no longer employees of CBC.
7. The Academy becomes a separate employer within the Fund and therefore reported separately (but still in the Fund totals).

<b>Table 1 LGPS Bedfordshire and CBC Membership at 31/3/13 and 31/3/18</b>				
	<b>Fund</b>	<b>Fund</b>	<b>CBC</b>	<b>CBC</b>
	<b>31 March 2013</b>	<b>31 March 2018</b>	<b>31 March 2013</b>	<b>31 March 2018</b>
<b>Active</b>	17,442	22,275	3,948	4,671
<b>Deferred</b>	21,142	30,160	6,755	4,176
<b>Pensioners</b>	13,158	16,436	4,131	1,101
<b>Total</b>	<b>51,742</b>	<b>68,871</b>	<b>14,834</b>	<b>9,948</b>

### **Draft Fund Account and Net Asset Statement**

8. The draft Fund Account and Net Asset Statement for the year ended 31 March 2018 shows that the value of the Fund at 31 March 2018 was £2,175 million, an increase of £101 million since 31 March 2017. During the year the Fund rebalanced its portfolio moving £36 million from All World Equities and investing in Absolute Return Multi Asset Funds in mid July 2017. In addition the Fund made its first investment in Standard Life Capital Secondary Opportunities Fund III (Private Equity) totalling £9.3 million. See table 2.

Table 2

2016/2017 £000		2017/2018 £000
	<b>Contributions and Benefits</b>	
108,936	Contributions	117,314
12,848	Transfers in from other pension funds	40,883
88	Other Income	67
121,872		158,264
-86,415	Benefits	-90,278
-7,552	Payments to and on account of leavers	-7,980
27,905	<b>Net additions/(withdrawals) from dealings with members</b>	60,006
-7,890	Management Expenses	-8,302
	<b>Returns on Investments</b>	
8,363	Investment income	10,138
-125	Taxes on income	-80
312,643	Profit and losses on disposal of investments and changes in value of investments	39,157
320,881	<b>Net return on investments</b>	49,215
340,896	Net increase/(decrease) in the Fund during the year	100,919
1,732,814	Net assets of the Fund at 1 April	2,073,710
2,073,710	<b>Net assets of the Fund at 31 March</b>	2,174,629

## Regulatory and Governance Changes

### Border to Coast

9. The Border to Coast Pensions Partnership has created the entity which is seeking to become an FCA-authorized alternative investment fund manager (AIFM); Border to Coast Pensions Partnership Ltd (“the Company” or “Border to Coast”).
10. Border to Coast is a wholly owned private limited company registered in England and Wales founded to carry out the asset pooling obligations set out by the Government. The Company has 12 equal shareholders who are the administering bodies of the 12 pension funds that are its customers (see below). The Company strives to be a customer-focused organisation with a strong oversight framework allowing regular interaction with its customers.
11. The Company will operate and offer investment funds for its closed book of customers to invest into based on the customers own allocation strategy. The five-year business plan outlines assets under management totalling approximately £43 billion (based on asset values as of 31st March 2017).

12. To deliver its services, the Company's revenue model will be Cost Recovery and Border to Coast will charge its 12 customers fees equal to operating costs in order to function.

13. BCPP comprises the following funds:

- Bedfordshire Pension Fund
- Cumbria Pension Fund
- Durham Pension Fund
- East Riding Pension Fund
- Lincolnshire Pension Fund
- North Yorkshire Pension Fund
- Northumberland Pension Fund
- South Yorkshire Pension Fund
- Surrey Pension Fund
- Teesside Pension Fund
- Tyne and Wear Pension Fund
- Warwickshire Pension Fund

### **Oversight of the Company**

14. The Administering Authorities of the LGPS funds that have established Border to Coast, and are its customers, have formed a Joint Committee made up of elected member representatives from each Administering Authority. The Joint Committee's role is to review the investment performance and capability on a quarterly basis. Border to Coast's delivery of services and its performance as a company against its strategic objectives is overseen by shareholder representatives both on an ongoing basis and formally once a year at its Annual General Meeting.

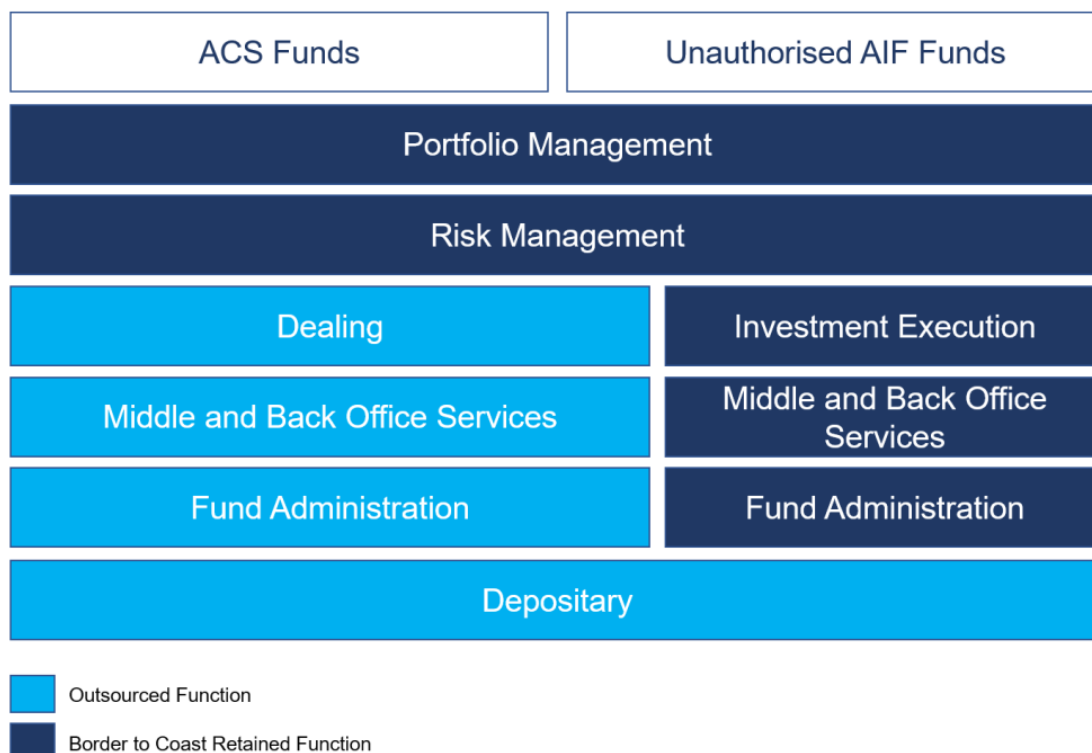
15. Border to Coast is managed and directed by its Board of Directors comprised of the Chairman and both executive and independent non-executive directors including the Chief Executive and Chief Operating Officers. The Chief Risk Officer also attends Board meetings. The Board's responsibilities are set out in the Company's Articles of Association, and subject to these articles, the directors are responsible for the management of the Company's business and implementation of the Strategic Plan. Day-to-day management of the Company is delegated to the Chief Executive Officer.

### **Delivering the Operating Model**

16. In order to successfully deliver its business strategy and customer services, Border to Coast has designed a split in-house and outsourced operating model. Border to Coast, as the AIFM, will provide

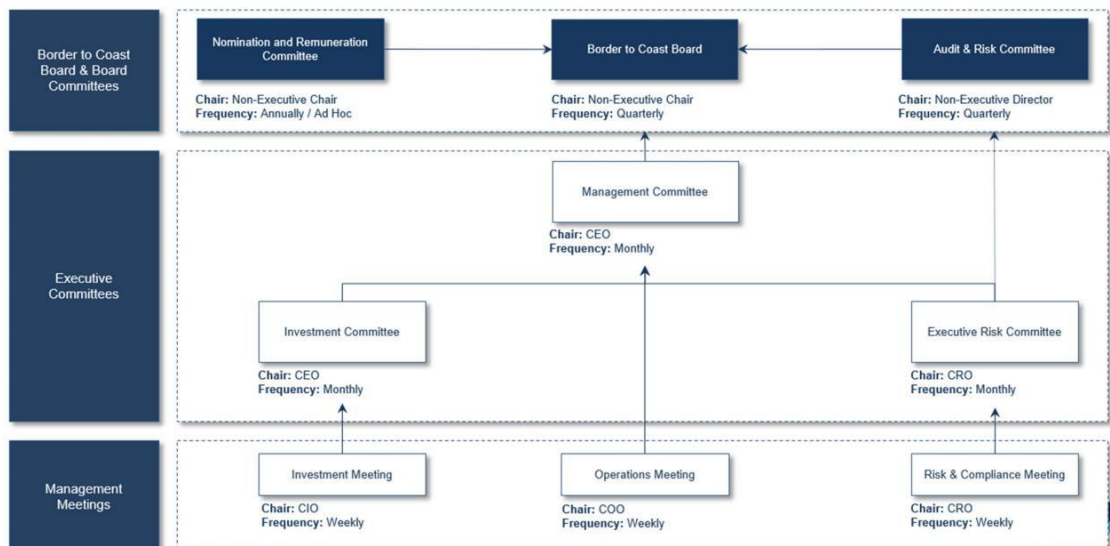
portfolio and risk management of the funds it manages with its own investment and risk teams in-house. These teams will be supported by the appointed TPA to which the Company has outsourced trade execution, the performance of middle and back office activities and fund administration for the listed financial instruments held in its funds.

17. As part of the phased approach to implementation and fund/sub-fund launches, those funds covering listed instruments will be the first offered by Border to Coast. Following the initial listed instruments sub-funds under the ACS, Border to Coast will be offering a range of funds covering non-listed and alternative assets as unauthorised AIF's. Portfolio and risk management for these funds will be carried out in-house but it has been decided that, whilst the alternative funds are being migrated/launched over the course of the 5-year plan, core middle and back office processing, valuations and fund accounting will also be retained in-house by the Company and not outsourced.
18. These activities will be retained until the Company assess that the non-listed portfolios and their operational requirements reach 'critical mass'. This decision will be based on portfolio complexity, size, number of investments and the complexity of the operational support required. At this stage Border to Coast will look to outsource these supporting services. An overview of how the Border to Coast operating model will initially be split is given in the diagram below:



## Governance

19. Border to Coast has designed and built its governance structure to meet, and account for, its regulatory responsibilities and industry best practice for organisations of its scale. Good governance is at the core of how Border to Coast does business. In this regard, the Board believes that corporate governance facilitates “effective, entrepreneurial and prudent management that can deliver the long-term success of the company”.
20. The Board is committed to maintaining high standards of corporate governance and believes that a sound corporate governance framework enables efficient and effective decision making with clear accountabilities, contributing to achieving the Company’s objectives and delivering long-term and sustainable value to its customers and shareholders. The Board’s intention is to achieve general adherence to the UK Corporate Governance Code (“the Code”), notwithstanding business size and closed shareholding.
21. Governance of Border to Coast will be led by the Board which is informed and supported by the Nomination & Remuneration and the Audit & Risk Committees. The Border to Coast Board will delegate executive management of the business to the Management Committee, from whom it will receive ongoing reporting.
22. The three layers of Border to Coast’s governance structure is outlined in the diagram below:



23. The Board is responsible for exercising day-to-day control over Border to Coast and will take the lead role in setting and overseeing the tone of cultures and behaviours at Border to Coast. The Management Committee’s role is to support the Chief Executive Officer in managing

the output and the escalations from Border to Coast's Executive Committees and report these into the Board.

24. The Management Committee will meet at least monthly and will be chaired by the Chief Executive Officer. The Management Committee has a direct reporting line from the regular Operations Meeting, chaired by the Chief Operating Officer, that sits every week.
25. The other executive committees (Investment and Executive Risk) will be responsible for managing operational and functional matters and are supported, and reported into, by regular Management Meetings. This structure of regular meetings reporting upwards

### **Cap on Exit payments**

26. As previously reported to Committee, there has been no movement from the Government on changes to the various exit payment reforms that the Government were in the process of introducing prior to the General Election. It is understood that parliamentary time and government legal support is in short supply for this area and nothing is expected to be issued until later in the year.

### **Task Force on Climate-related Financial Disclosures**

27. The Pension Fund joined with other investors, investment managers and other organisations to support the development of Climate related final disclosures after this was highlighted by the Institute Investors Group on Climate Change. This was completed in time for the One Planet Summit held in Paris and two year anniversary of the Paris Agreement on 12 December 2017.

### **Markets in Financial Instruments Directive II (MIFID II)**

28. 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.
29. This directive came into force on 3 January 2018. The Fund has chosen to opt up and be classified as professional clients under Markets in Financial Instruments Directive II.

## Actuarial Valuation and Employer Contributions

30. The actuarial review was covered in detail in the report to the Audit Committee in January 2017. The next actuarial review is not due until 2019.

### CBC Certified Employer Contribution Rates

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

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
<b>2017/18</b>	<b>16.9</b>	<b>5.903</b>	<b>24.2</b>
<b>2018/19</b>	<b>16.9</b>	<b>7.073</b>	<b>25.2</b>
<b>2020/21</b>	<b>16.9</b>	<b>8.296</b>	<b>26.5</b>

32. 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.
33. 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.
34. 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.



35. 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.
36. 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.

### **Admitted Body Application/Employer Update**

37. Bedford College merged with Tresham College, a college in Northamptonshire on 1 August 2017. Bedford College requested Secretary Of State approval to transfer all pension liability to Bedfordshire Pension Fund (BPF). Approval was received in December 2017, with 138 active and 460 deferred members transferred from the Northamptonshire Pension Fund to the Bedfordshire Pension Fund in December 2017, and 222 pensioners records transferred in February 2018. The Funds' actuaries are now calculating the asset value to be transferred.
38. It was anticipated that the transfer of assets would be completed within the financial year 2017/2018, however the process of reconciling membership numbers between 2016 and the transfer date has taken longer than anticipated. Northamptonshire Pension Fund made an interim payment of £9,000,000 on 27 March 2018. Both the Fund and the Director of Finance at College are actively working with Northamptonshire Pension Fund to expedite matters.
39. Totternhoe Lower in Central Bedfordshire Council joined Diocese St Albans Multi Academy Trust from 1 February 2018.

### **Pension Fund Performance to 31 March 2018**

40. The Fund value ended the quarter slightly lower than the previous quarter due to a reduction in the value of equities following market volatility during February 2018 resulting from concerns of trade tariffs to/from the US. This reduction was offset by an increase in the level of cash held at the end of the quarter.
41. The market value of the Fund and cash holdings at 31 March 2018 was £2,151.5 million, a decrease of £42.1 million from £2,193.6 million held at 31 December 2017 and an increase of £424.1 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.

42. The Pension Fund net investment return for the quarter ending 31 March 2018 was -2.8% which is behind the benchmark return of -0.2%.
43. The performance for the preceding 12 months was 2.3% behind the benchmark return of 4.0% per annum (pa).
44. The performance over the preceding 3 year period was 10.4% pa which is ahead of the benchmark return of 7.1% pa.
45. The performance over the preceding 5 year period was 7.2% pa which is ahead of the benchmark return of 6.3% pa. 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 the fixed interest markets returned a positive return.

#### **Asset allocation.**

46. At its meeting on 22 November 2016 the Pension Committee considered the results of Asset Liability Modelling to ensure that it has the appropriate asset allocation. The current asset allocation is shown at Table 4.
47. The commitment to property of £25 million, agreed at the Pension Fund Committee on 11 March 2014, has not been further committed from that reported at the last Committee with £27 million still being held in cash by the investment manager. Officers are meeting with CBRE at the beginning of August to discuss the matter further.
48. A further drawdown to the Standard Life Opportunities Fund III was completed during the quarter, with the investment in Private Equity now standing at £8.1 million as at 31 March 2018. The commitment of £25 million to Pantheon Real Assets Strategic Opportunities Fund was approved by the Committee during March 2018 and the first drawdowns have followed in the next quarter.

<b>Table 4 Bedfordshire Fund Investment Asset classes and values at 31 March 2018</b>					
<b>Asset class</b>	<b>31 Dec 17</b>	<b>31 Dec 17</b>	<b>31 Mar 18</b>	<b>31 Mar 18</b>	<b>Bench mark</b>
	<b>£M</b>	<b>%</b>	<b>£M</b>	<b>%</b>	<b>%</b>
UK Equities	204.0	9.3	190.7	8.9	9
Overseas and Global Equities	916.2	41.8	871.8	40.5	41
<b>Total Equities</b>	<b>1120.2</b>	<b>51.1</b>	<b>1062.5</b>	<b>49.4</b>	<b>50</b>
Government Bonds	65.8	3.0	66.0	3.1	
Index Linked Gilts	110.8	5.1	111.0	5.1	
Absolute return Bonds	175.5	8.0	175.1	8.1	
<b>Total Bonds</b>	<b>352.1</b>	<b>16.1</b>	<b>352.1</b>	<b>16.3</b>	<b>18</b>
Property – (Indirect))	199.7	9.1	190.7	8.9	10
Multi Asset Absolute Return	423.8	19.3	418.1	19.4	20
Private Equity	4.5	0.2	8.1	0.4	
Cash	93.3	4.2	120.0	5.6	2
<b>Total Fund</b>	<b>2193.6</b>	<b>100</b>	<b>2151.5</b>	<b>100</b>	<b>100</b>

## Liabilities

49. The Fund monitors its valuation position with a regular report from the Actuary called Navigator. The Navigator report has been reviewed and is presented in a new format to provide greater clarity and focus. The funding level as at 31 March 2018 stood at 71%, equal to that at the 31 March 2016, and an increase from the estimated deficit reported in December from £799 million to £883 million at 31 March 2018. The most significant movement is the reduction in investment returns, relating to prevailing market conditions.

## **Opportunistic Investments**

50. 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.
51. 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.
52. 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.
53. 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.
54. The Fund is able to invest up to 2% in Opportunistic Investments, 1% of which had been allocated to the Standard Life SOF III.
55. 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.

## **Council Priorities**

56. 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**

57. 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**

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

59. 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**

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

## **Conclusion and next Steps**

61. 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