Central Bedfordshire Council

AUDIT COMMITTEE 11 March 2019

Local Government Pension Scheme Update

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Purpose of this report

1. To provide an update on the performance and 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 5.8 million members. The scheme, which currently invests some £271 Billion in assets (as at March 2018), 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 Ministry for Housing, Communities and Local Government.

4. Bedford Borough Council is the administering authority for the Bedfordshire Pension Fund and the Fund's Administrator is the Borough Council's Assistant Chief Executive (Enabling).

5. Bedford Borough Council's responsibilities as Administering Authority are undertaken through the Pension Fund Committee, which comprises elected members of Bedford Borough Council, Luton Borough Council and Central Bedfordshire.

6. 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.

Membership

7. At 31 March 2018 the Fund had 171 employers and 66,134 members. See Table 1 below.

Table 1

Fund membership		
	31.03.18	**31.03.17**
Active members	22,275	21,140
Pensioners	16,436	15,538
Deferred pensioners	30,160	29,456
Totals	**68,871**	**66,134**

8. CBC has 9,948 members as at March 2018. See table 2 below:

Table 2 LGPS Bedfordshire and CBC Membership at 31/3/13 and 31/3/18

	Fund	**Fund**	**CBC**	**CBC**
	31 March 2013	**31 March 2018**	**31 March 2013**	**31 March 2018**
Active	17,442	22,275	3,948	4,671
Deferred	21,142	30,160	6,755	4,176
Pensioners	13,158	16,436	4,131	1,101
Total	**51,742**	**68,871**	**14,834**	**9,948**

9. 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.

10. The Academy becomes a separate employer within the Fund and therefore reported separately (but still in the Fund totals).

Pensions Fund Account and Net Asset Statement as at March 2018

Table 3

Pension Fund Account Summary	2017/18 £M	2016/17 £M
Contributions & Benefits		
Employee contributions	24.3	23.4
Employer contributions	93.0	85.5
Transfer values received	40.9	12.9
Other income	0.1	0.1
Total income	**158.3**	**121.9**
Pensions & other benefits	90.3	86.4
Transfer values and refunds paid	8.0	7.6
Net additions/ (withdrawals) from dealings with members	**60.0**	**27.9**
Management Expenses	8.3	7.9
Returns on Investment		
Investment income less tax	10.1	8.2
Profit/(loss) on disposal and change in investment value	**39.2**	**312.6**
Movement of funds		
Opening net assets	2,073.7	1,732.8
Surplus for investment	61.7	28.3
Change in value of assets	39.2	312.6
Closing net assets	**2,174.6**	**2,073.7**

11. During the year the value of the Fund increased by £101 million to £2,175 million its highest value.

Table 4

Market value of fund assets at 31 March 2018	%of fund	Market value £M
Pooled investments	94.7	2,058.718
Cash and other	5.3	115.851
Totals	**100.0**	**2,174.629**

12. Also, 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.

13. The Fund's external managers and the market value of the assets under their control as at 31 March 2018 are shown in table 5 below:

Table 5

Manager	Fund %	Market value £M
Legal & General	26.1	567.130
BlackRock	25.5	553.257
CBRE	10.0	217.544
Insight	8.0	174.876
Invesco	7.1	155.249
Pyrfords	6.8	148.415
Trilogy	5.5	118.547
Newton	5.3	114.493
SL Capital	0.4	9.267
In-house managed	5.3	115.851
Total	**100.0**	**2,174.629**

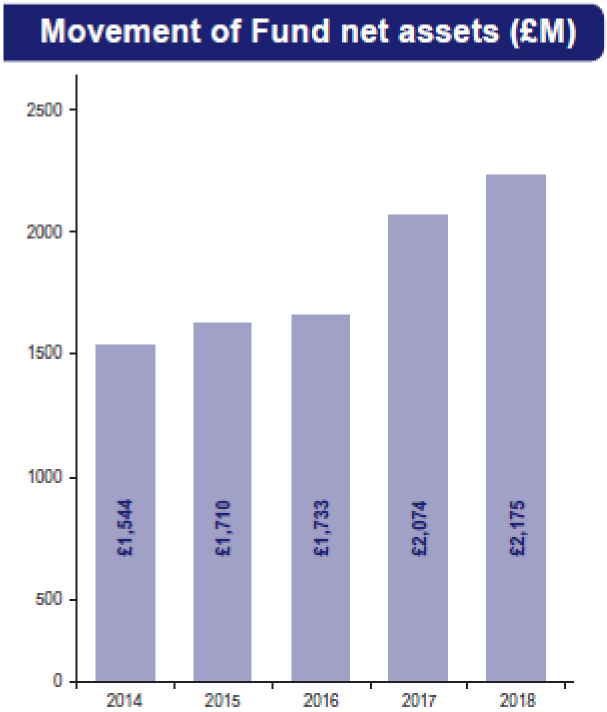
14. The returns by asset class and movement of fund net assets are below at table 6 and 7.

Table 6

Returns by asset class 2017-2018		
	Fund %	Benchmark %
Overall	2.3	4.0
UK equities	2.55	1.25
Overseas equities	6.34	1.25
Fixed interest securities	0.53	0.46
Absolute Returns Bonds	0.15	2.41
Index Linked Bonds	0.68	0.53
Property	9.47	10.05
Absolute Return Multi Asset*	-1.09	5.68

* The Absolute Return Multi Asset portfolios are a strategic mix of different asset classes.

Table 7



Appointment of a new Actuary

15. Barnett Waddingham (BW) have been appointed as the new Actuary taking over from Hymans Robertson from 1 October 2018. The Membership and Investment data has been transferred and reconciled with the new actuary and is now being reviewed by Bedford Borough's Internal Audit Service.

16. BW employ over 1,100 staff based at several offices. Of these, 130 staff are currently actuaries and BW acted as Actuary for 25% of all Local Government Pension Schemes (LGPS) offering a bespoke funding model and strategic support.

Regulatory and Governance Changes

LGPS: Technical Amendments to Benefits – Policy Consultation

17. Ministry for Housing, Communities and Local Government (MHCLG) opened an eight week policy consultation called 'LGPS: technical amendments to benefits' to consider three areas:

   • Survivor benefits – introducing changes to provide that pensions paid to survivors of civil partnerships or same-sex marriages will be equal to those provided to widows of male members. The changes will be backdated to the date civil partnerships and same-sex marriages were implemented, this means that LGPS administering authorities will need to revisit all awards made under the current rules to civil/same-sex partners and pay any additional sums that are due.

• Introducing a general power for MHCLG to issue statutory guidance.

• Correcting the unintended error in the LGPS (Amendment) 2018 Regulations to provide that deferred members who left under the 1995 Regulations are able to take payment of their LGPS pension without the need for their former employer's consent from age 55, with the appropriate actuarial reduction.

18. The closing date for the consultation was 29 November 2018.

GAD Section 13 Valuation

19. The Government Actuary Department (GAD) has published its findings of the first review of Section 13 (following the dry run in 2013). Subsection (4) of Section 13 requires MHCLG to report on four key aims:

• Compliance – whether the fund's valuation is in accordance with Scheme Regulations;

• Consistency – whether the fund's valuation has been carried out in a way which is not inconsistent with the other fund valuations within LGPS;

• Solvency – whether the rate of employer contributions is set at an appropriate level to ensure solvency of the fund;

• Long term cost efficiency – whether the rate of employers contributions is set at an appropriate level to ensure the long term cost efficiency of the scheme.

20. Compliance and Consistency refer to the process and methodologies of the Actuarial Valuation. GAD found all actuarial valuation reports for the sample tested had been completed in accordance with the regulations. In relation to consistency, GAD found marked differences between discount rates, mortality improvements, salary increases and commutation that were not due to local circumstances. GAD has therefore recommended the Scheme Advisory Board (SAB) undertake further work to consider what steps should be taken to achieve greater clarity and consistency in actuarial assumptions, and on a common basis for future conversions of schools to academy status.

21. GAD define solvency as considering the rate of employer contributions being set at an appropriate level to ensure solvency of the fund and there is capacity to increase employer contributions to achieve 100% funding/an appropriate plan if there were a limited number of fund employers. GAD assessed risk against a range of measures, two of which are highlighted in the report. 74 of the 89 funds tested received green flags on all solvency measures (an improvement since 2013 of 56 out of 90).

(a) SAB Funding Level – The report highlights that there is an existing risk for those employers with the lowest funding levels. Those funds in the bottom decile are listed in the report on Page 29. Bedfordshire Pension Fund is within that decile, quoted as -13% (joint 8th from bottom) from the mean average funding resulting in an amber flag. GAD has not engaged with Bedfordshire Pension Fund (BPF) regarding any specific concerns about the funding level. We believe this measure alone is not insightful and given that BPF are not flagged anywhere else within the GAD report, this would imply that regardless of current funding position the funding plan is robust and credible. Officers will be discussing the GAD findings, and our funding level in more detail with Barnett Waddingham as part of the 2019 Valuation.

(b) The Report also considers Asset Shock which stress tests a sustained reduction in the value of return seeking assets and the employer contributions required to meet the emerging deficit. Four funds have received an amber flag which are discussed in more detail on Pages 31-32 with specific recommendations for West Midlands Integrated Transport Authority. BPF received a green flag in this area.

22. Long Term Cost Efficiency considers whether the rate of employer contributions are set at an appropriate level to ensure that payments are not deferred into the future to disproportionately affect future generations of taxpayers. 83 of the 89 funds had green flags on all long term cost efficiency measures. The Cipfa Funding Strategy Statement Guidance states “Administering Authorities should avoid continually extending the deficit recovery periods at each and subsequent actuarial valuations… [And] aim to reduce deficit recovery periods”. The report recommends all funds review their Funding Strategy Statement to ensure handling of surplus or deficits are fair to both current and future taxpayers.

2018 Autumn Statement

23. The Chancellor made a number of announcements in his Autumn Statement on 29 October 2018 that affect the Pension Fund and its employers. The most significant change relates to the Scape (superannuation contributions adjusted for past experience) Discount Rate which is discussed in detail in paragraph 24 to 28, a summary of the other changes are set out below:

• Pension increases will be in line with Consumer Price Inflation Housing (CPIH), instead of Consumer Price Inflation (CPI),although the date of any change has not been confirmed. CPIH is CPI but including housing costs (the average change in residential rents) included in the basket of goods that are measured. As housing costs often increase quicker than other goods CPIH is generally higher than CPI (but not always). All else being equal this would increase pension fund liabilities lightly;

• The lifetime allowance has been increased to £1.055m for the year 2019/2020 and currently increases in line with CPI each year but CPIH may also be adopted for this purpose.

• The National Living Wage (NLW) will increase by over 11% to £8.21 an hour from April 2019. Although this is unlikely to have a material impact at fund level, this will have implications for LGPS employer pension costs, in monetary terms, as those members on NLW will accrue a higher CARE pot in the future.

SCAPE Discount rate change

24. The Chancellor also confirmed the reduction in the SCAPE discount rate from CPI + 2.8% to CPI +2.4%. The SCAPE discount rate is used to set all the employer contributions in the unfunded public sector pension schemes and determine the actuarial factors used across all the public service pension schemes.

25. The reduced rate became effective from 29 October 2018 for the calculation of actuarial factors in the LGPS – this means that some non-club transfers, some inter-fund calculations and all CETVs for divorce must be put on hold until new actuarial factors are issued. It is anticipated that the new transfer factors will be issued by the Secretary of State within 6 weeks of 29 October.

26. All of the Scheme's actuarial factors will need revising following the change to the SCAPE discount rate, though MHCLG have confirmed that these can be implemented at a slower rate as they do not have to be effective from 29 October 2018.

27. It has been agreed by MHCLG, GAD, LGA and LGPS software providers that if there are any changes to calculations, these will be communicated with software providers in advance of their introduction so that changes can be made to pension administration systems in time for the implementation of the new factors.

28. Communications with members who may be affected by these impending changes have commenced.

Separation Project

29. In 2015 the Scheme Advisory Board (SAB) commissioned KPMG to undertake a project to examine the issues and challenges of separating the pension's functions of the LGPS administering authorities from their host authorities to successfully manage the potential conflicts of interest arising between the pension fund and its parent local authority. A further project for 2019/2020 has been established to see how the recommendations could be made to work in practice. Hymans Robertson have been appointed to undertake this project.

Cost Cap

30. SAB at its meeting on 10 October 2018 considered a statement from the Treasury regarding the scheme valuations for the public service pension schemes, including the LGPS. For the unfunded schemes, a reduction in the discount rate will result in significant increases in employer contributions while the outcome of the cost cap floor of 2% being breached is expected to lead to improvements in member benefits. For the LGPS, employer rates are set by local fund valuations (next in 2019) but the cost cap mechanism does potentially impact. The SAB cost management process which will now progress with any changes to benefits being taken into account in the HM Treasury process. Based on work undertaken by the

SAB’s actuarial adviser, the total cost of the scheme (employer and employee) under the Board’s process is 19% against a target total scheme cost of 19.5%.

31. Further work will be undertaken by SAB to agree a package of benefit changes to return the scheme to its total target cost of 19.5% while also looking at employee contributions at the lower end.

32. The outcome of the Cost Cap is now on hold pending the outcome of the McCloud case. The case concerns transitional protections to members that were given in the judges and firefighters schemes as part of the public service pensions reform that the Court of Appeal in December 2018 ruled were unlawful on grounds of discrimination. The Government is now appealing to the Supreme Court for permission to appeal.

Committee Makeup

33. The Committee have previously requested that Bedford Borough Council add a substitute to the Committee in line with Central Bedfordshire and Luton Councils. Full Council on 10 October 2018 approved the appointment and Councillor James Saunders was appointed to the Pension Fund Committee.

Cap on Exit payments

34. 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.

Actuarial Valuation and Employer Contributions

35. The actuarial review was covered in detail in the report to the Audit Committee in January 2017. The next actuarial review will take place during 2019 to take effect from 1 April 2020.

CBC Certified Employer Contribution Rates

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

Table 8 – 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**
2019/20	**16.9**	**8.296**	**26.5**

37. 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 other actuarial assumptions including 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 employers in the Bedfordshire Fund.

38. 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.

39. CBC pays a 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.

40. 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.

41. Note that we are currently exploring paying the deficit recovery payment as an up front lump sum as a number of Councils have found that an up front payment is less than the cost of paying annually over three years. Some County Councils have saved between £1.5M to £2.0M.

Pension Fund Performance to 31 March 2018

42. The Fund value ended the quarter slightly higher than the previous quarter. The market value of the Fund and cash holdings at 30 June 2018 was £2,237.1 million, a decrease of £85.6 million from £2,151.5 million held at 31 March 2018 and an increase of £509.7 million since the 31 March 2016 (the date of the last triennial valuation) value of £1,727.4 million.

43. The positive performance since the triennial valuation has primarily come from the equities asset class.

44. The Pension Fund net investment return for the quarter ending 30 June 2018 was 3.75% which is behind the benchmark return of 4.09%.
45. The performance for the preceding 12 months was 5.3% behind the benchmark return of 8.35% per annum (pa).

46. The performance over the preceding 3 year period was 10.4% pa which is ahead of the benchmark return of 2.4% pa.

47. The performance over the preceding 5 year period was 8.1% pa which is ahead of the benchmark return of 1.0% pa.

Asset allocation.

48. 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 8.

49. 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 £28 million currently being held in cash by the investment manager. Officers met with CBRE on 2 August 2018 to discuss the performance of the Fund, to further challenge CBRE on the slow commitment of funds, and meet the new Portfolio Manager Mark Adcock. CBRE acknowledge that commitment has been slow, however, as at 30 June, there were £10 million of commitments that had not yet been drawn down. Since the end of the quarter the Fund has been notified of a number of new internal investments that have taken place; as at the end of July the level of cash held was £24 million.

50. The commitment of £25 million to Pantheon Real Assets Strategic Opportunities Fund was approved by the Committee during March 2018. There have been five drawdowns over the quarter, with the total committed at 30 June 2018 at approximately £8.5 million.

51. The value of cash held has also increased over the quarter to £97.9 million. It is anticipated that a proportion of the cash will be required to fund the transfer out of an employer.

Table 9 Bedfordshire Fund Investment Asset classes and values at 31 March 2018					
Asset class	**30 Jun 18**	**30 Jun 18**	**31 Mar 18**	**31 Mar 18**	**Bench mark**
	£M	**%**	**£M**	**%**	**%**
UK Equities	207.6	9.3	190.7	8.9	9
Overseas and Global Equities	925.8	41.74	871.8	40.5	41
Total Equities	**1133.4**	**50.7**	**1062.5**	**49.4**	**50**
Government Bonds	66.2	3.0	66.0	3.1	
Index Linked Gilts	109.8	4.9	111.0	5.1	
Absolute return Bonds	169.7	7.6	175.1	8.1	
Total Bonds	**345.7**	**15.5**	**352.1**	**16.3**	**18**
Property – (Indirect))	218.6	9.8	190.7	8.9	10
Multi Asset Absolute Return	423.4	19.0	418.1	19.4	20
Private Equity	9.7	0.4	8.1	0.4	
Infrastructure	8.4	0.4	0	0	
Cash	97.9	4.4	120.0	5.6	2
Total Fund	**2273.1**	**100**	**2151.5**	**100**	**100**

Liabilities

52. The funding level as at 30 June 2018 stood at 73.9% (70.8% as at 31 March 2016), and a reduction from the estimated deficit reported in March from £883 million to £790 million at 30 June 2018. The most significant movement is the increase in investment returns, relating to prevailing market conditions.

Council Priorities

53. 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

54. 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 Housing, 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

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

56. 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

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

Conclusion and next Steps

58. 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

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