

PENSIONS COMMITTEE

15 March 2023

Title: Administration and Governance Report	
Report of the Chief Financial Officer	
Public Report	For Decision
Wards Affected: None	Key Decision: No
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Accountable Director: Philip Gregory, Chief Financial Officer	
Accountable Strategic Leadership Director: Fiona Taylor, Acting Chief Executive	
Summary This report provides Members with an update on any administration and governance changes that have occurred and the potential impact that these changes may have on the Pension Fund. The report also provides an update on the Fund's one year and three-year cashflow forecast and on the London Collective Investment Vehicle (LCIV) as the Fund moves towards more pooled investments.	
Recommendations The Committee is recommended to note: <ul style="list-style-type: none">i. Pension Fund Budget 1 April 2023 to 31 March 2025,ii. That the Fund is cash flow positive,iii. London CIV update,iv. Update from the Independent Investment Advisor,v. The results of the 2022 actuarial valuation, including the improved funding level. The committee is recommended to agree: <ul style="list-style-type: none">vi. The updated Funding Strategy Statement for a 30-day consultation with the Fund's employers and the final version to be approved by the Finance Director in consultation with the Chair,vii. That no further prepayments are made to the pension fund for contributions and that the prepayment of £20m made for 2023/24 contributions is repaid to the Council, andviii. That £25m worth of Baillie Gifford units are sold, with the cash used to fund the repayment.	

1. Introduction

1.1 It is best practice for Members to receive regular administration data and governance updates. This report covers six main areas including:

- i. Pension Fund Prepayment Options
- ii. Pension Fund Budget 1 April 2023 to 31 March 2025,
- iii. Cashflow to 31 December 2022,
- iv. London CIV update,
- v. Update from the Independent Investment Advisor,
- vi. The results of the 2022 actuarial valuation, and
- vii. The updated Funding Strategy Statement.

2. Pension Fund Prepayment Options

- 2.1 As part of the Council's savings options, it prepaid two years of pension contribution totalling £40m to the Pension Fund for 2022/23 and again for 2023/24. A prepayment of contributions is where a lump sum payment is made to the Pension Fund by the Council, and it is based on the likely employer contribution. During the year, the first-year prepayment is repaid in twelve equal amounts (i.e. £20m is repaid in twelve equal amounts), with the actual employer contributions paid each month to ensure that the correct contribution rates are paid.
- 2.2 For the prepayment, an amount is paid by the Pension Fund to the Council that equates to the discount rate. For 2022/23 to 2023/24 this equated to an effective interest rate of 4.0%. The prepayment allowed the Fund to meet capital calls for Infrastructure and to fund Diversified Alternatives, without the need for the Fund to sell any assets to Fund these investments.
- 2.3 The table below shows the current asset allocation against the target and range. The Fund is currently fully invested, with no short-term borrowing but with the £25m of prepayment made by the Council for employer contributions. The table illustrates this position:

Table 1: Current Asset Allocation

Asset Class	Current Position	Strategic Allocation Target	Variance	Range
Equities	55.4%	52%	3.4%	50-60
Diversified Growth	14.9%	15%	-0.1%	14-18
Infrastructure	7.4%	8%	-0.6%	7-11
Credit	5.1%	8%	-2.9%	6-10
Property	3.9%	5%	-1.1%	4-7
Diversified Alternatives	10.8%	9%	1.8%	7-10
Fixed Income	2.3%	3%	-0.7%	3-5
Cash	0.1%	0%	0.1%	0-1

- 2.4 While the prepayment from the Council has allowed the fund to cover the capital calls for alternatives and remain fully invested, there are a number of factors that make the prepayment less appealing, including:
1. There is greater scrutiny of the prepayments by auditors. While the prepayment has been agreed by the auditors, they have advised that this approach will come under further scrutiny in future.
 2. The Council has a greater need for the cash to fund its developments and there is a preference within the Council to no longer make the prepayment.

3. The Fund is currently overweight equities and diversified alternatives, and a sale would reduce this overweight allocation to nearer the strategic target allocation, while also improving the allocations of all other assets as the total assets are reduced by £25m. The table below shows the

Table 2: Asset Allocation after £25m sale of Equities

Asset Class	Current Position	Strategic Allocation Target	Variance	Range
Equities	54.5%	52%	2.5%	50-60
Diversified Growth	15.2%	15%	0.2%	14-18
Infrastructure	7.6%	8%	-0.4%	7-11
Credit	5.2%	8%	-2.8%	6-10
Property	4.0%	5%	-1.0%	4-7
Diversified Alternatives	11.0%	9%	2.0%	7-10
Fixed Income	2.4%	3%	-0.6%	3-5
Cash	0.1%	0%	0.1%	0-1

- 2.5 The strategy is currently undergoing a strategic review and, as equities are an easier and cheaper asset class to divest from, especially if the sale is to cash, rather than a reinvestment, it is recommended to sale £25.0m of equities rather than alternatives.
- 2.6 Within equities, the Fund has three managers, as shown below.

Table 2: Asset Allocation after £25m sale of Equities by Manager

Equity Fund Manager Holdings as at 28 February 2023	Current Equity Market Values (£Ms)	Current Equity Market Values (£Ms)
Baillie Gifford	272.24	247.24
Kempen	227.56	227.56
UBS Equities	257.68	257.68
Equity Holding	757.47	732.47

- 2.7 The allocation to each equity manager should be evenly split. However, over time, the outperformance by Baillie Gifford and the underperformance by Kempen has resulted in Baillie Gifford having a much larger allocation than the allocation to Kempen. It is recommended that Members agree to sell £25.0m from Baillie Gifford.
- 2.8 The £25.0m is required to provide the Fund with the £20.0m for the repayment but also will leave £5.0m available to cover working capital requirements for the Fund as it moves to a cashflow negative position from April 2023.
- 2.9 It is therefore recommended that the prepayment of £20m for 2023/24 is ended and repaid to the Council on 31 March 2023 and that £25.0m is sold from Baillie Gifford Paris Aligned fund to provide funds for the repayment but also to provide cash to the fund to manage its working capital and also as part of a rebalancing of the asset allocation to equities and the individual holdings of the equity managers.

3. Pension Fund Budget 1 April 2022 to 31 March 2025.

3.1 Table 1 provides Members with the Fund's three-year budget to 31 March 2025.

	2022/23	2023/24	2024/25
	£000s	£000s	£000s
Income			
Council	8,681	9,068	9,341
Admitted bodies	467	448	415
Scheduled bodies	1,908	1,933	1,891
Total contributions from members	11,055	11,449	11,646
Council - Normal	27,822	27,801	28,635
Admitted bodies - Normal	1,938	1,860	1,724
Scheduled bodies - Normal	7,383	7,477	7,316
Pension Strain	250	500	250
Total contributions from employers	37,393	37,638	37,925
Total Contributions	48,449	49,086	49,572
Individual Transfers	3,500	3,500	3,500
Total Income Before Investments	51,949	52,586	53,072
Expenses			
Pensions			
Council	- 30,891	-34,999	- 36,049
Admitted Bodies	- 394	- 447	- 460
Scheduled Bodies	- 6,610	- 7,490	- 7,714
Total	-37,895	-42,935	- 44,223
Lump sums			
Council	- 3,957	- 3,957	- 3,957
Admitted Bodies	- 388	- 388	- 388
Scheduled Bodies	- 748	- 748	- 748
Total	- 5,093	- 5,093	- 5,093
Death grants	- 1,400	- 1,500	- 1,600
Payments to and on account of leavers	- 4,500	- 4,500	- 4,500
Total Expense	- 48,888	- 54,028	- 55,416
Net Income / (Expenditure) Excl Investments and Management Costs	3,061	- 1,441	- 2,344
Total Management Costs (cash)	- 3,204	- 1,887	- 1,958
Net Income / (Expenditure) Excluding Investments	- 143	- 3,328	- 4,302
Investment Income			
BlackRock	2,400	2,472	2,546
Hermes	500	515	530
Total	2,900	2,987	3,077
Net Income / (Expenditure) - cash	2,757	- 341	- 1,225

3.2 The three-year budget has fairly stable member numbers. A 10.1% increase in pensions in 2023/24 due to the current high level of inflation has risen the total expenses forecasted. There is an average salary increase of 6.6%, however as the council contribution will fall from 23% to 22%, this will partially offset the increase in

income in 2023/24. Pension Strain is forecasted in increase as a result of the Council's savings programme due to central government funding cuts.

A decrease in management expenses is being forecasted as the prepayment from the council is repaid so no interest payments are due to be made. Excluding investments, the fund is expected to be cashflow negative for the next 3 years. There is investment income expected from two investments managers of approximately £3m per annum. Overall, the Fund is expected to be cashflow positive, after investment income, for 2022/23 and negative in the following 2 years.

- 3.3 On 1 April 2022 a £20m prepayment was paid to the Pension Fund from the Council, as agreed by Members at the March 2022 Committee. This prepayment helped to repay a short-term loan made to the Fund from the Council.

4. Cash flow to 31 December 2022

- 4.1 Table 2 below provides Members with the Fund's Cash flow to 31 December 2022.

Table 2: Actual Pension Fund Cash Flow to 31 December 2022

	2022/23 Budget £000's	2022/23 Forecast £000's	Over / Under £000's
<u>Contributions</u>			
<u>Employee Contributions</u>			
Council	8,700	9,147	447
Admitted bodies	500	488	-12
Scheduled bodies	2,000	1,968	-32
<u>Employer Contributions</u>			
Council	28,200	28,655	455
Admitted bodies	2,100	2,014	-86
Scheduled bodies	7,700	7,555	-145
Pension Strain	1,000	1000	-
Transfers In	3,500	3,042	-458
<u>Total Member Income</u>	53,700	53,869	169
<u>Expenditure</u>			
Pensions	-37,600	-38,063	-463
Lump Sums and Death Grants	-6,500	-6,431	69
Payments to and on account of leavers	-4,400	-7,120	-2,720
Administrative expenses	-800	-800	-
<u>Total Expenditure on members</u>	-49,300	-52,415	-3,115
<u>Net additions for dealings with members</u>	4,400	1,454	-2,946
<u>Returns on Investments</u>			
Investment Income	15,000	15,000	-
Profit (losses)	50,000	50,000	-
Investment management expenses	-4,500	-4,500	-
<u>Net returns on investments</u>	60,500	60,500	-
<u>Net increase (decrease) in net assets</u>	64,900	61,954	-2,946
<u>Asset Values</u>	1,406,180	1,300,902.69	-105,277
<u>Liabilities</u>	1,305,583	1,211,364.95	-94,218
<u>Funding Level</u>	107.71%	107.39%	2.31%

5 London Collective Investment Vehicle (LCIV) Update

5.1 LCIV is the first fully authorised investment management company set up by Local Government. It is the LGPS pool for London to enable Local Authorities to achieve their pooling requirements. Below are the investments the Fund currently has with CIV.

	30/09/2022	Market Move	31/12/2022
Active Investments	£	£	£
LCIV Global Alpha Growth Fund	258,598,008	3,010,873	261,608,881
LCIV Global Total Return Fund	110,830,587	3,569,369	114,399,956
LCIV Real Return Fund	76,807,666	2,839,470	79,647,136
Total	446,236,261	9,419,712	455,655,973

5.2 Update from the London CIV

At 31 December 2022, the total assets deemed pooled stood at £25.8bn. Assets under management in the ACS stood at £12.6bn. The value of 'pooled' passive assets was £11.9bn, which is managed by L&G and BlackRock. AUM has increased due to more favourable market conditions from September 2022 to December 2022 by £2bn.

6. Independent Advisor Update: John Raisin

6.1 Introduction

This paper informs and updates the Committee in respect of a number of important issues relating to the LGPS at a national level. The issues covered in this paper are:

1. Climate Reporting.
2. Investment Pooling.
3. Pension Fund Accounts.
4. Consultation on changes to the Scheme Advisory Board (SAB) Cost Management process.
5. Reclassification of the Further Education sector.
6. LGPS Pensions Increase 2023.

6.2 It is hoped that this paper will be informative to all Members of the Pensions Committee and in particular to those who have joined the Committee following the May 2022 Council elections.

Climate Reporting

6.3 The Consultation on Governance and reporting of Climate Change risk which was issued on 1 September 2022 closed on 24 November 2022. It is understood that the DLUHC received approximately 120 responses to the Consultation.

6.4 The volume of responses means that there has been a delay in the DLUHC responding to the Consultation and issuing the final Regulations and any associated Guidance. It is still expected however that, as proposed in the Consultation, LGPS Funds will be required to produce their first Climate Risk Report under the new Regulations by December 2024. It is anticipated that the relevant new Regulations will apply from 1 April 2023 but that they will likely be issued after 1 April and applied retrospectively.

Investment Pooling

- 6.5 The Consultation on the future development of Investment (Asset) Pooling expected since 2019 has still not yet been issued. The Chancellor of the Exchequer Rt Hon Jeremy Hunt MP did however include reference to this in a Statement on “Financial Services” he made on 9 December 2022 which included that the Government “Will, in early 2023, consult on new guidance to the Local Government Pension Scheme (LGPS) in England and Wales on asset pooling.”
- 6.6 It is understood that the future of Investment Pooling has been subject to active consideration within the DLUHC and therefore a Consultation may reasonably be expected to be issued during 2023, although the actual timing is not clear.

Pension Fund Accounts

- 6.7 Regulation 53(1) of the LGPS Regulations 2013 (as Amended) requires Administering Authorities (including the London Borough of Barking and Dagenham) to “maintain a pension fund...” However at present in England the Pension Fund Account forms part of the overall Accounts of the Administering Authority. Due to delays in the preparation and publication of Administering Authority main accounts delays are consequently occurring in the publication of the Pension Fund Annual Report that each LGPS Administering Authority has a statutory responsibility to publish by 1 December each year.
- 6.8 Consequently on 3 August 2023 the Chair of the Scheme Advisory Board (SAB) wrote to the (then) Minister Responsible for the LGPS Paul Scully MP. The SAB letter urged the Government to support the separation of the Pension Fund Annual Accounts in England from those of their Administering Authority as has already happened in both Wales and Scotland. The SAB letter to Government included the following:
- 6.9 “The issues behind delays in the external audit of local authority accounts are much wider and not related to the preparation of pension fund annual accounts. The Board is firmly of the view that, so long as pension fund accounts remain part of the main local authority accounts, problems unrelated to pension fund accounts will continue to impact on the timely publication of the pension fund accounts and the pension fund annual report...”
- 6.10 “When it last met on June 6th , the Board agreed to recommend the separation of the pension fund annual accounts in England from the administering authorities’ own accounts, as is already the case for the LGPS in Scotland and Wales... Indeed, it is notable that in Scotland and Wales 80% of pension funds managed to publish audited pension fund accounts on or before 1st December 2021, whilst in England only 17% of audited pension fund annual reports were published by the same date”
- 6.11 “...It would also assist with reform of audit in local government more widely by removing a complex, and specialist area from the main administering authority accounts. This would be helpful as part of the wider goal in ensuring the timely and robust audit of local authority accounts, benefiting the health of the LGPS and local government finance in general.”
- 6.12 On 15 February 2023 the Minister now responsible for the LGPS, Lee Rowley MP sent a response to the SAB which indicated that the DLUHC is actively considering

the SAB recommendation to completely separate the Pension Fund Annual Accounts of English LGPS Funds

- 6.13 “I recognise the scope and complexity of issues affecting external local audit, and the impact that this is having on reporting by local authorities and LGPS funds. The Pension Fund Annual Reports and the Scheme Annual Report are vital in maintaining transparency and accountability of the LGPS to members, employers, and taxpayers...”
- 6.14 “I welcome the Board’s advice and recommendation to consider the separation of main authority accounts and the pension fund accounts, in addition to the package of support for local audit already in place. I have asked my officials to consider the scope for developing this further.”

Consultation on changes to the SAB Cost Management process

- 6.15 The Public Service Pensions Act 2013 introduced into the major public service pension schemes, including the LGPS, a cost control mechanism to seek to ensure the cost of providing pensions is kept within a cost range. The cost control mechanism is primarily concerned with calculating the cost of providing benefits to Employees of each of the major public service pension schemes.

For the LGPS in England and Wales there are two cost control mechanisms:

- The employer cost cap (ECC) process as operated by HM Treasury.
- The future service cost (FSC) process as operated by the LGPS Scheme Advisory Board (SAB).

- 6.16 The seven major Public Sector Pension Schemes are subject to the cost cap process operated by HM Treasury. However, as the LGPS (alone) is a funded Scheme a second cost management process was established. This can use different assumptions around the cost of providing member benefits, for example, it can use a different discount rate to reflect that the LGPS is a funded scheme. The SAB process operates prior to the HM Treasury process, and recommendations made as a result (and accepted by government) are considered when calculating the scheme costs for the purpose of the HM Treasury process.
- 6.17 If either cost control process shows that the costs of providing benefits have risen or fallen outside of a target level, recommendations can or must (in certain circumstances) be made which would bring them back to target. These may include additions to or reductions to future benefits and adjustment of Employee contribution rates.
- 6.18 In 2021 the Government Actuary undertook a review of the cost cap process as operated by HM Treasury. This resulted in the Government making certain changes to this process including widening the corridor from 2% to 3% of divergence of pensionable pay from the target cost required to result in a breach of the cost control mechanism resulting in a reduction in the likelihood of changes to a Scheme.
- 6.19 On 30 January 2023 DLUHC launched a Consultation (which closes on 24 March 2023) entitled “Local Government Pension Scheme: Changes to the Scheme Advisory Board cost management process” The Consultation aims to update the SAB

process in light of the 2021 changes to the HM Treasury cost control process and to provide the SAB with greater flexibility in how it responds to any cost variations.

Reclassification of Further Education sector

- 6.20 On 29 November 2022 the Office for National Statistics (ONS) announced that it had reclassified statutory Further Education (FE) sector (FE colleges, Sixth Form Colleges and designated institutions) and their subsidiaries in England. As a result of this review these bodies have been reclassified by the ONS from Non-Profit Institutions to the Central Government Sector. In effect this means that these bodies are now part of Central Government.
- 6.21 Schedule 2 Part 1 of the LGPS Regulations 2013 requires Further Education bodies to offer their non-teaching staff membership of the LGPS. Presently the Department for Education (DfE) does not provide a central government guarantee and therefore there is a high risk for a LGPS Fund should a Further Education body become insolvent. Furthermore, the DfE Policy paper “Further education reclassification: government response” (published 29 November 2022) states “The reclassification of the FE sector does not require any action for colleges with regards to the local government pension scheme.” Therefore, the Government has not committed to providing any additional covenant assurances or guarantees for Further Education employers.
- 6.22 Going forward were central government to provide a guarantee it would potentially provide more support in respect of Further Education liabilities. Furthermore the SAB has stated that it will be discussing the wider implications of this change in classification with the Department for Education. However even if a guarantee were provided the impact of the reclassification would need to be assessed by each LGPS Fund for each of its Further Education employers and decisions taken as to whether any changes in the funding approach to such employers be made.

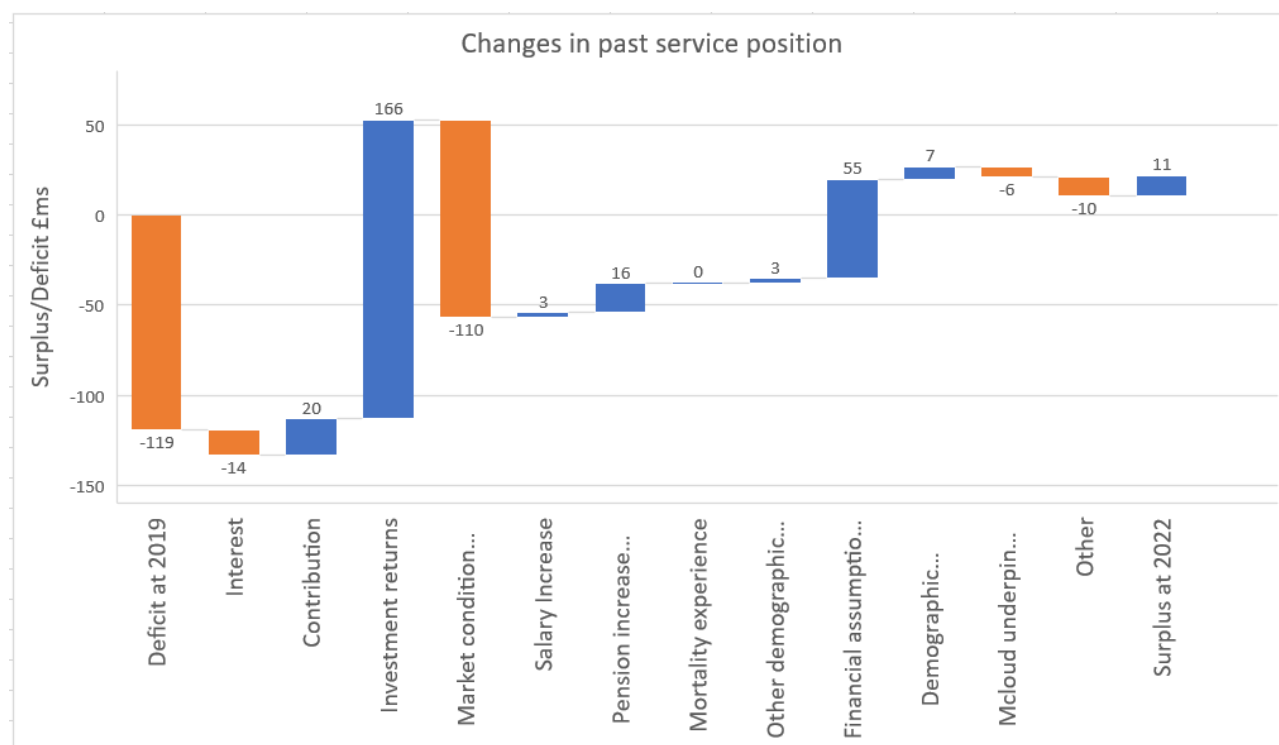
LGPS Pensions Increase 2023

- 6.23 On 20 February 2023, the Pensions Increase and Revaluation Order for public sector pensions was published alongside a written ministerial statement. These confirmed that LGPS pensions will be increased by 10.1% from April 2023.

7. Triennial Valuation 2022

- 7.1 Every three years the Pension Fund is required to have a full valuation of its liabilities carried out by its actuary.
- 7.2 Officers have discussed the valuation assumptions with the actuary and agreed the main assumptions, including the deficit contributions rate, the discount rate and salary increase assumptions. As a result of these discussions the actuary could produce the whole fund valuation calculations. The results show that, at a whole Fund level, the deficit has reduced from £119m to £11m and the funding level has improved to 101% from the 2019 level of 90%.
- 7.3 The main contributors to the reduced deficit and improved funding level are outlined in chart 1:

Chart 1: Movements in Triennial Valuation Assumptions



7.4 Overall the fund has adopted a prudent discount rate of 4.3%. This is higher than the 4.0% used in the 2019 valuation.

7.5 Below is a summary of the agreed financial assumptions and the results:

Valuation Date	2007	2010	2013	2016	2019	2022
Past Service Liabilities	£Ms	£Ms	£Ms	£Ms	£Ms	£Ms
Employees	-£285	-£298	-£316	-£324	-£323	-£420
Deferred Pensioners	-£81	-£117	-£180	-£221	-£287	-£315
Pensioners	-£239	-£314	-£406	-£456	-£531	-£571
Total Liabilities	-£605	-£729	-£902	-£1,001	-£1,141	-£1,306
Assets	£530	£549	£636	£772	£1,022	£1,317
Surplus / (Deficit)	-£75	-£180	-£266	-£229	-£119	£11
Funding Level	88.00%	75.40%	70.60%	77.20%	90.00%	101.0%
Discount Rate	6.10%	6.10%	4.70%	4.10%	4.00%	4.30%
Salary Increases	4.70%	5.30%	3.80%	2.60%	3.00%	3.90%
Price Inflation	3.20%	3.30%	2.50%	2.10%	2.30%	2.90%

7.6 A meeting was held on the 10th of February 2023 with the with the actuary and the Fund's various employers to discuss the draft Triennial Results. Representatives from the University of East London, and a representative for many of the Fund's academies were present.

7.7 The draft triennial results indicated that the contribution rates for employers varied with some rates dropping and some remaining the same.

8. Funding Strategy Statement

8.1 After the triennial valuation is completed the FSS must be updated. The purpose of the FSS, as stated by the Department for Communities and Local Government (DCLG) is:

- *“to establish a **clear and transparent fund-specific strategy** which will identify how employers’ pension liabilities are best met going forward;*
- *to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and*
- *to take a **prudent longer-term view** of funding those liabilities.”*

8.2 These objectives are desirable individually but may be mutually conflicting. Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the Administering Authority to implement and maintain.

8.3 This statement sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers’ contributions, and prudence in the funding basis.

8.4 The objectives of the Fund’s funding policy are as follows:

- i. to ensure the long-term solvency of the Fund and the long-term solvency of shares of the Fund attributable to individual employers,
- ii. to ensure sufficient funds are available to meet all benefits as they fall due,
- iii. not to restrain unnecessarily the investment strategy of the Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk,
- iv. to help employers recognise and manage pension liabilities as they accrue,
- v. to minimise the degree of short-term change in the level of each employer’s contributions where the Administering Authority considers it reasonable to do so,
- vi. to address the different characteristics of the disparate employers or groups of employers to the extent that this is practical and cost-effective; and
- vii. to use reasonable measures to reduce the risk to other employers and ultimately to the Council Taxpayer from an employer defaulting on its pension obligations.

8.5 The actuary and officers have produced an updated FSS, which is included as Appendix 1 of this report. This will be distributed to all Fund employers and will be taken to the Pension Board for comments.

8.6 A summary of key changes includes:

- Cessation approach - given the volatility of gilt yields and the desire for a more stability and consistency the actuary has developed a new approach based on the actual investment strategy and a greater level of prudence

8.7 All proposed amendments have been made to the FSS and therefore, subject to any amendments put forward by Committee Members, the report in Appendix 1 is included for agreement by Pensions Committee Members for a 30-day consultation with the fund's employers and the final version to be approved by the Finance Director in consultation with the chair of the Pensions Committee.

9. Financial Implications

Implications completed by: Philip Gregory, Chief Financial Officer

9.1 The Pension Fund is a statutory requirement to provide a defined benefit pension to scheme members. The management of the administration of benefits the Fund is supported and monitored by the Pension Board.

10. Legal Implications

Implications completed by: Dr Paul Feild Senior Governance Solicitor

10.1 The Council operates the Local Government Pension Scheme which provides death and retirement benefits for all eligible employees of the Council and organisations which have admitted body status. There is a legal duty fiduciary to administer such funds soundly according to best principles balancing return on investment against risk and creating risk to call on the general fund in the event of deficits. With the returns of investments in Government Stock (Gilts) being very low they cannot be the primary investment. Therefore, to ensure an ability to meet the liability to pay beneficiaries the pension fund is actively managed to seek out the best investments. These investments are carried out by fund managers as set out in the report working with the Council's Officers and Members.

11. Consultation

11.1 Council's Pension Fund governance arrangements involve continuous dialogue and consultation between finance staff and external advisers. The Finance Director and the Fund's Chair have been informed of the commentary in this report.

Appendix 1 – Funding Strategy Statement

Background Papers Used in the Preparation of the Report: None