Local Pension Board and Local Pension Committee

Key roles and responsibilities

Local Pension Committee

- It is the main committee responsible for ensuring that the Leicestershire LGPS operates effectively
- A committee of Leicestershire County Council but includes voting members from other stakeholders (City Council, District Councils, Universities)
- Has three non-voting staff representatives
- Previously called the Pension Fund Management Board

Local Pension Committee

- Is a decision-making committee
- Is set up to fulfil Leicestershire County Council’s statutory responsibility to act as Administering Authority for the LGPS
- Deals with investment and administration issues
- Role in terms of administration has generally been restricted to setting broad policies

Local Pension Board

- Is a requirement within LGPS Regulations, following on from the Public Sector Pension Act 2013
- Is not a decision-making body
- Is required to assist Scheme Manager (i.e. administering authority) in ensuring compliance with Regulations and other statutory requirements

Local Pension Board

- Has no role in respect of the Fund's investments, other than ensuring that proper governance is carried out in the decision-making process
- Should understand how the investment portfolios operate in order to assist them in fulfilling this responsibility
- There is no expectation that they should be 'knowledgeable' in investments

Board and Committee – Common Values

- Individual members must be sufficiently knowledgeable to be able to fulfil their roles
- It was clearly acknowledged by DCLG that it would take time for Board members to reach a reasonable level of knowledge
- New members of the Committee also take time to reach an adequate level of understanding
- Both play key roles in ensuring Fund Governance is of a high standard

Board and Committee – Different Roles

- Within the Public Sector Pension Act 2013 there was a clear desire within Central Government to ensure that administration and governance standards within Public Sector Pension Schemes improved
- It is widely thought that this was aimed at the unfunded schemes with central administration, and the LGPS was something of an afterthought
- Board's role is about ensuring that administration is carried out effectively, that Regulations are being complied with and that decisions are made within an appropriate framework

Board and Committee – Different Roles

- Committee has the expectation that Board will deal with matters mainly relating to administration. Certain matters are best dealt with by the Board (e.g. updating certain policies), but responsibility for the policies ultimately lies with the Committee
- Committee will generally only get involved in administration matters if there are major issues, or if they are of significant strategic importance

Fund Investments (and what they are intended to pay for)

Current position and how we got there

Fund Investments - History

- Until late 1990's (and a long while after for some Funds) most LGPS Funds tried to outperform each other, and used one or more 'balanced' managers
- Managers were not necessarily good in all areas of investment, so 'specialist' management took off
- Fund-specific benchmarks now the norm

Fund Investments - Evolution

- 20 years ago there were really only 3 main asset classes – equities, bonds and property
- Now there are an increasing number of sub-classes within each main asset class
- And some ‘new’ asset classes that were not really available to institutional investors then (commodities, hedge funds, infrastructure etc.)

Leicestershire’s Evolution

- Two ‘balanced’ managers and a property manager until 1999
- Specialist UK equity, overseas equity and bond mandates introduced in 1999 but a balanced manager retained for some time after
- Fund-specific benchmark introduced at the same time
- Benchmark is aware of liability structure but is not directly linked to it
- Now entirely specialist

Annual Strategy Meeting

- Investment strategy (where you invest) is at least 90% of the risk
- Annual Strategy meetings started in mid-2000’s
- Asset allocation should be ‘evolution not revolution’
- Ensures Fund’s assets are capable of producing acceptable performance over the medium-term

Current Fund Asset Allocation

Asset Type	Benchmark
Equities	50.5% - 52.5%
Property	10%
Inflation-Linked	12.5%
Alternative Assets	25% - 27%

Asset Allocation Pragmatism

- Fund requires a long-term REAL investment return of 4% p.a., after expenses
- As a result the majority of assets have to be return-seeking, rather than liability matching
- Liability matching would push employer contribution rates up to unaffordable levels
- Risk is taken where it is likely to be best rewarded

Management Expenses

- Different asset classes and management styles have very different fee levels. Important to focus on expected return NET of all fees
- Large proportion of equities are in index-tracking funds (cheap and about to get cheaper)
- Where there is a more ‘hands-on’ requirement to manage the assets (private equity, infrastructure etc.) fees are higher

Management Fees

- Some managers charge fees directly to the Fund via invoice. In 2014/15 these amounted to £5.4m (0.18% of average assets)
- Taking into account expenses taken from within pooled funds, the actual cost was about £13.5m (0.46% of average assets)
- Investment return achieved (+15.6% vs. benchmark of 11.4%) is NET of the total cost

Summary

- Matching asset allocation to liabilities is unaffordable
- Asset allocation needs to be able to provide the required return (and hopefully more), but also needs to take account of the risks
- Diversification is important, but is no use if it reduces returns too much
- Asset allocation will always be a compromise but should be a compromise based on long-term investment beliefs and expectations

Summary

- Investment returns DO NOT impact onto benefits payable. They do impact onto contribution levels payable by employers
- Investments are inherently volatile – even ‘safe’ investments do not go up in a straight line
- Investment management cost is inevitable and it is worth paying higher fees if higher returns are achieved. But costs are guaranteed and returns are not, so care needs to be taken

Asset Pooling within the LGPS

- It will happen within the lifetime of the current Parliament
- Lots of work currently going on
- Will reduce investment management fees but may also reduce ability for individual Funds to implement their investment wishes completely
- The LGPS needs to push for a structure that is workable and decreases cost without reducing investment performance

Investments are only half the equation

- Liabilities are calculated by the actuary
- Actuarial valuation every three years
- Next one based on position at 31/3/16
- Will set employer contribution rates for period 1/4/17 – 31/3/20
- Vast majority of employers will see increases in contribution rates
- Affordability crucial to the future of the LGPS

Actuarial position

- 31st March 2013:
  - Assets £2.6bn, Liabilities £3.6bn, Deficit £1.0bn
  - Future service rate 18.2%. Including deficit repayment over 20 years 28.4%
- 30th September 2015 (estimated):
  - Assets £3.0bn, Liabilities £4.4bn, Deficit £1.4bn
  - Future service rate 22.0%. Including deficit repayment over 20 years 36.9%

Why has position changed?

- Assets have performed broadly in line with assumptions
- Gilt yields have fallen, so expected future investment returns have decreased
- Less of cost to be paid for by investment returns = more of cost to be paid for by employer
- Employee contributions laid out in Statutory Instruments

Actuarial assumptions, and why they matter

- Future investment return assumptions REALLY matter (£1 at a 5% return for 40 years = £7. At a 4% return = £4.80)
- Every one year increase in life expectancy increases total liabilities by about 5%
- Pay rise assumptions impact on final-salary element of benefits (pre-2014 service)
- Inflation impacts directly onto benefits paid

Can things get better?

- Yes – gilt yields rising would increase expectations for future investment returns and lower liability values
- Future investment returns could be above expectations
- Life expectancy increases may slow (McDonalds Generation)
- Future inflation may be lower than expected

Grim reality?

- Higher gilts yields will not be sufficient on their own
- Will also require decent investment returns
- Even this combination is unlikely to completely resolve the issue
- Higher employer contributions for a long period of time are almost inevitable
- We hope that we are at a particularly bad point at present