Local Government Pension Scheme- Background and Update on Pooling

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Local Government Pension Scheme – the Basics

- A statutory, defined benefit pension scheme
- The employees of the majority of scheme employers have a right to membership (Scheduled Bodies)
- Some scheme employers can allow their staff to join the LGPS IF they pass an appropriate resolution (Designation Bodies)
- Others have admission agreements to be scheme employers (outsourcing etc.)

Local Government Pension Scheme – the Basics

- Employee contributions are set within the Regulations, and the rate payable depends on pensionable pay. Rates range from 5.5% to 12.5% and average c.6.4%
- Benefits payable are laid out in Regulations and are guaranteed
- Employer pays what is required to ‘balance the books’

Local Government Pension Scheme – the Basics

- LGPS is the only ‘funded’ Public Sector pension fund in the UK
- Investment returns pay part of the cost of benefits, so they really matter
- Employer pays the balance, and employers’ rates are set every three years as part of the actuarial valuation process

Actuarial Valuation

- Carried out every three years
- Calculates current ratio of assets to accrued liabilities
- Calculates the employers’ contribution rates required to pay for future service as it accrues
- Sets contribution rates that will pay off the deficit over an agreed period (which varies by employer-type) and pay for future service

Leicestershire’s Strategic Asset Allocation

• Equities	48% - 50%
• Targeted Return	11 ½%
• Global Credit	7 ½%
• Index-Linked Bonds	7 ½%
• Property	10%
• Infrastructure	5%
• Emerging Mkt Debt	2 ½%
• Timberland	2%
• ‘Opportunity Pool’	4% - 6%

Leicestershire’s Strategic Asset Allocation

- Is set in order to achieve the rate of return that is required to remove the existing deficit over 20 years at current employer contribution rates
- Risk-aware, rather than risk-averse
- Expected return is 4% over CPI in the long-term

Fund Numbers

- Value of assets 31/3/17 = c. £3.9bn
- Estimated value of liabilities 31/3/17 = c.£5bn
- Membership = 88,000 (33,000 active, 25,000 pensioners, 30,000 deferred)
- Contributions received 2016/17 = £167m
- Benefits paid 2016/17 = £143m
- Impact of 0.1% increase in investment returns over 10 years* = £70m in capital value

* Annual 6.1% returns instead of 6.0%

Local Pension Committee (LPC)

- As LGPS is a statutory pension fund, there are no trustees
- Each LGPS Fund has an ‘administering authority’
- The administering authority is responsible for all aspects of the LGPS – both administration and investment
- As members of the Local Pension Committee, you are quasi-trustees
- But there is no legal liability for individuals

Responsibilities of the LPC

- Agreeing investment strategy
  - Assistance from investment consultant, independent advisor and officers
- Understanding and managing risk
  - Most risks relate to investments
- Agreeing key assumptions within triennial actuarial valuation
- Agreeing and reviewing Fund policies

LPC Meetings

- Quarterly, plus an additional Annual Strategy Meeting (in January)
- Aim to be informative and to keep members up-to-date with markets
- Will incorporate training on a regular basis
- Investment Subcommittee (ISC) also exists to deal with more detailed work referred to it by LPC, and to deal with investment manager hiring/firing

Knowledge and Skills

- In order to fulfil their responsibilities adequately, individual members must have appropriate knowledge and skills
- Increasing scrutiny in this area from Scheme Advisory Board and The Pensions Regulator
- Necessary to ‘prove’ these skills exist
- Report on how to achieve this proof will be produced for September meeting

Why the LPC matters

- Employer contributions pay for the difference between the benefits payable and employee contributions plus investment returns
- Every pound earned in investment returns is a pound that the employer is not required to pay into the Fund
- Every pound not paid into the Fund by the employer can be spent on the provision of services

LGPS Pooling - Background

- Government initiative. All Funds must pool to achieve economies of scale.
- 4 criteria:
  - Scale (at least £25bn)
  - Strong governance and decision making
  - Reduced costs and excellent vfm
  - Improved capacity for infrastructure investment

LGPS Pooling - Background

- Pooling announced in July 2015
- Criteria laid out in November 2015
- 8 LGPS Pools have emerged and look likely to be launched
- Pools to be managing assets by 1st April 2018
- Financial Conduct Authority (FCA) authorisation a requirement

LGPS Pooling – Leicestershire's Partners

- LGPS Central comprises 8 administering authorities, and 9 LGPS Funds
- Cheshire, Derbyshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands, West Midlands Integrated Transport Authority, Worcestershire
- Asset value £40bn

LGPS Central – Progress so far

- Funds started talking with each other in November 2015
- An immediate recognition from all Funds that pooling was going to happen, and that we had to make the best out of it
- Huge amount of work put in so far by Officers – and there is more to come
- Timetable is very tight, but will be achieved

LGPS Central – Progress so far

- Funds recognise the need to compromise if cost savings are going to be maximised
- Compromises are modest
- Chair and CEO of LGPS Central appointed
- Progress well ahead of most pools
- FCA registration application is expected to be completed in early July

LGPS – Progress so far

- Regulatory Business Case that will support FCA application will be agreed by Shareholder Representatives (in our case, the Chair of this Committee) on June 19
- Director of Finance has been involved in formulating the business case

LGPS Central – Cost Savings

- The business case shows all Funds making significant savings in the long-term
- Start-up costs will lead to additional cost for a number of years
- Requirement to operate as an FCA-authorised entity brings additional on-going costs
- Restructuring costs on assets will also impact onto cost savings

LGPS Central – Cost Savings

- Business case uses prudent assumptions in terms of future investment management fees etc.
- These savings may well be surpassed
- No supposition of improved investment performance
- LGPS Central will look to expand internal investment management capability gradually, which will lead to major savings

LGPS Central – what it means to Leicestershire

- This committee still makes THE key decision – strategic asset allocation
- LGPS Central will be responsible for implementing the Fund’s asset allocation
- Investment manager hires and fires will be the responsibility of LGPS Central
- LGPS Central will be accountable to the Fund for performance within each asset class

LGPS Central – common policies

- In order for LGPS to function effectively, there has to be agreed policies in certain areas.
- There is already great commonality in these areas.
- These will include:

  - Voting at company meetings
  - Environmental, Social and Governance
  - Responsible Investment

Will Leicestershire still be able to do what it wants from an investment perspective?

- There may be small compromises, but in the main the answer will be ‘yes’.
- Closer working between the funds may make investment in certain asset classes more effective
- We will also have a developing ‘Centre of Excellence’ to help us

LGPS Central – Regulatory Capital

- Requirement for £16m of Regulatory Capital in order to fulfil FCA requirements
- Each Shareholder will provide £2m of capital
- Leicestershire's capital will be paid by the Fund
- Amount is not significant and would have otherwise have been held as cash by the Fund
- Capital will earn a higher rate of interest than if cash was retained here

LGPS Central - Summary

- Progress has been excellent
- Funds are very closely aligned in their thinking
- Where necessary, compromise has been easily achieved
- Regulatory Business Case should be approved by Funds on 19th June 2017
- Requirement to invest £2m in LGPS Central to provide Regulatory Capital

LGPS Central - Summary

- Will achieve 1st April 2018 ‘go-live’ date
- Cost savings will be achieved, albeit with higher costs for a period of time
- Investment returns should not be harmed, and there is a strong case to suggest they should improve

Any Questions?