



LOCAL PENSION COMMITTEE - 11 SEPTEMBER 2020

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

**RISK MANAGEMENT, INTERNAL CONTROLS AND
BUDGET UPDATE**

Purpose of the Report

1. The purpose of this report is to inform the Committee of any changes relating to the risk management and internal controls of the Pension Fund, as stipulated in the Pension Regulator's Code of Practice. In addition, an update to the 2020/2021 budget is included.

Background

2. The Pension Regulator's (TPR) code of practice on governance and administration of public service pension schemes requires that administrators need to record, and members be kept aware of 'risk management and internal controls. The code states this should be a standing item on each Pension Board and Pension Committee agenda.
3. In order to comply with the code the risk register and an update on supporting activity is included on each agenda.
4. In November 2019 The Good Governance Project in the Local Government Pension Scheme (LGPS) Phase two report was published. This report was from the working groups to the Scheme Advisory Board.
5. The report includes several proposals on how to improve governance in the LGPS. The favoured option from the engagement activity was greater ring-fencing of the LGPS within existing structures, greater separation of pension fund management from the host authority, including **budgets**, resourcing and pay policies. The Pension Committee should also be included in the **business planning process**.
6. Finalisation of the Good Governance proposals have been delayed due to the Covid crisis. Nevertheless, it is seen as good practice for the Committee to receive the Business Plan and Budget. This was undertaken in February with the intention of allowing the Committee to ensure the Pension Section is adequately resourced to continue to provide the level of service required by scheme members and Fund employers over the next financial year. The Committee approved the £45.35million Pension Fund budget on 28 February 2020.

Risk Register

7. The updated risk register has been attached as an appendix to this report.
8. Risk 1 - Has been expanded to make it more explicit, if Guaranteed Minimum Pension data is incorrect it can impact on the Pensions Increased (PI) received by pensioners.
9. Risk 7 – A new risk has been added; Contributions bandings and contributions not applied correctly, could both impact on the income expected to be received by the Fund. This is included in the Fund’s internal audit plan.
10. Risk 8 – A new risk has been added; If immediate payments are not applied correctly, scheme members one off payments could be wrong. The Fund has recently taken on the responsibility for processing one off payments and this is included in the Fund’s internal audit plan.

Internal Audit (IA) Activity

11. The proposed IA activity for the year was agreed as follows:

<u>Proposed Cyclical Programme of Collective Internal Audit Work</u>	Staffordshire County Council	West Midlands	Shropshire County Council	Leicestershire County Council	Worcestershire County Council	Nottingham County Council	Cheshire West & Chester	Derbyshire County Council
Partner Pension Fund IA Function/Collective IA Review								
2019/20								
Governance/Company & Financial & Operational Risks	✓	✗	✗	✗	✗	✗	✗	✗
Company Risks – Review of AAF/0106 Control Report and Feedback	✓	✓	✓	✓	✓	✓	✓	✓
Investment Risks	✗	✓	✗	✗	✗	✗	✗	✗

12. Governance/Company & Financial & Operational Risks – this was finalised early January 2020 and agreed by PAF. No ‘weak’ controls were identified as part of this audit.
13. Company Risks – Review of AAF/0106 Control Report and Feedback. (Audit & Assurance Faculty). An AAF report was produced to give assurance to the eight Partner Funds on the internal control environment within LGPS Central Limited. The report covers a three-month period from 1 January 2020 to 31 March 2020. The Partner Funds agreed that this first report would cover only the first three months of 2020 so that it would align with their own audit cycle. An unqualified opinion was awarded by the reporting accountants.
14. Investment Risks – this audit is on going, the draft is complete with progress slowed by CV19. It is expected to be complete in the coming months before being presented to the audit group.
15. At this stage there is no reason to add anything to the risk register.

Budget update for 2020/21

16. The 2020/21 budget and current forecast with comments is summarised within the report below.

The Budget and forecast for 2020/21

Budget Heading	2020/21 BUDGET	20/21 FORECAST	NOTES
Staffing	1,300	1,300	Includes £100k provision for additional McCloud resource. If not needed then will likely be closer to £1,200k
IT costs	500	450	Year to date £400k, most large payments concluded
Actuarial costs	400	100	£30k year to date, most actuarial cost has been recharged to employers
Support Services	400	400	In line at present
LGPS Central costs (Governance, operator running costs, product development)	950	920	Updated based on current costs per Central
Investment Management Expenses (split below)			
1. Management	26,400	24,000	Lower average AUM for the year, assuming 6% growth pro rata to March 21.
2. Transaction	9,900	9,900	Transactions expected to be in line with budget
3. Performance	5,500	5,500	April 20 to March 21 expected to be within budget
Sub Total	41,800	39,400	
Total	45,350	42,570	

17. Officers expect the cost of the operating the Pension Fund to be c6% lower than the budget approved in February. The majority of the saving is estimated to come from investment management fees which are based on assets under management (AUM). The Fund has forecast a 6% pro rata investment return from the June 2020 valuation. If the Fund outperforms this assumption, then

investment management expenses are likely to rise. This estimate includes an estimated £300k saving on actuarial fees where the Fund has passed costs to LGPS employers where possible.

18. Moving investments to Central products will affect in year investment management expenses. In many cases the ongoing investment management costs would be lower than the costs the Fund currently pays. However, in the short term where we are transitioning funds to Central products there will be one off transition costs that will impact the transaction element in the above table.
19. In 2020/21 the Fund may 'benefit' from lower a total valuation leading to lower costs from managers who charge based on assets under management (AUM).
20. However, the Fund is also undertaking a number of changes in line with the Strategic Asset Allocation which was approved in January 2020, these will move some investments into funds that charge slightly higher fees with the expectation of giving the fund a lower value tilt bias. The Fund is also moving some investments into Central Funds that will charge lower fees an example of which is included within the private section of today's meeting. Leicestershire County Council is implementing spend control due to CV-19, the pension administration and management will not be impacted by the introduction of these controls.

Staffing

21. The Pensions Administration staffing budget covers staffing related costs for 32 full time equivalent staff. A new structure will be implemented from 1 January 2021 to include a team to support scheme governance and improvements. Improvements include best utilising the new pensions administration system and driving efficient working processes wherever possible.
22. The McCloud remedy remains outstanding but a temporary team of initially three colleagues from the Pension Section will be assigned to work on McCloud. This team will commence on the 1 January 2021 to coincide with the new structure.
23. Within the percentage rate that employers pay there is an allowance of 0.3% for administration expenses. This was detailed in all the employer schedules provided as part of the Fund valuation.

LGPS Central costs oversight, governance and product development

24. These are the costs of governance, running costs and product development as incurred by LGPS Central and allocated to Leicestershire Pension Fund under the cost sharing agreement between the Partner Funds that own LGPS Central. At the time when the Committee approved the Fund's budget the LGPS Central budget was not approved but has since been agreed.
25. Under this agreement the Fund's share of costs is now estimated at £0.92 million. Governance costs are split equally between the eight local authorities. Operator running costs are split based on AUM and product development costs

are allocated based on products that our Fund has expressed an interest in and assets being invested.

IT Costs

26. Following a full tender the Pension Section invested in a new pensions administration system in 2018/19 including pensioner payroll, IConnect for employers to submit data monthly, the main core system, workflow and image, and member self-service.

Actuarial Charges

27. Actuarial charges were budgeted at £400,000 in 2020/21. However, employer requests for actuarial work are recharged back to the employer after the work is complete and the current forecast is now £100,000.
28. Officers have started the initial tender work for actuarial services within 2020/21 and it is expected the largest four LGPS actuarial firms will bid for the work. Costs will form part of the tender evaluation.

Support Services

29. Support Services are made up of strategic financial and operational finance charges from East Midlands Shared Services, e.g. for providing the pensioner payroll service. The charge also includes legal services.

Investment Management and Expenses

30. This is split into three sections and compiled using historical data of expenses by category received from our investment managers using a third party. There could be deviations from these numbers given the historical nature of the analysis and constant changes within fee structures and changes of investment manager. For example, moving from current managers to pooled funds run by LGPS Central.
31. A reduction is now forecast for this element based on lower assets under management. If investment performance is higher than expected, then fees will consequently increase but the Fund will see a benefit versus expected returns.

Fund Governance – Budget

32. It is important to note the Pension Fund budget is independent of the Council's budget and its finances are managed separately. The budget is sufficient to meet the Funds statutory requirements.
33. The Director of Corporate Resources does not restrict changes in the Pension Fund Budget in the same manor that may be done for the Council's own budget. There is a clear independence that meets one of the Good Governance requirements in Hymans November 2019 phase two report.

34. The current budget is a one year budget but will be move to 4 year budget in line with the Medium Term Financial Strategy (MTFS)
35. Investment management costs are volatile and are likely to be higher than budgeted if investment performance exceeds assumptions. Therefore the costs detailed in the report could significantly change.

Recommendation

36. It is recommended that the Committee notes the report.

Background Papers

[Local Pension Committee 28 February 2020 - Pension Fund Business Plan and Budget 2020/21](#)

Equality and Human Rights Implications

None

Appendix

Appendix - Risk Register

Officers to Contact

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