



LOCAL PENSION BOARD - 8 FEBRUARY 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PENSION FUND – BUSINESS PLAN AND BUDGET 2021/22

Purpose of the Report

1. The purpose of this report is to inform the Board of the Pension Section's Business Plan and Pension Fund's proposed budget for 2021/22.

Background

2. 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.
3. 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 Board may also be included in the **business planning process**.
4. The Pension Section's business plan and Pension Fund budget for 2020/21 was approved by Pensions Committee, but in previous years had been agreed with the Director of Corporate Resources, as the senior administering authority office responsible for the Fund.
5. To comply with the governance proposal both the 2021/22 Business Plan and Budget will be submitted to the Committee for approval on 26 February 2021 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.

Business Plan

6. The Pension Section's Business Plan details the main changes that impact on the Pension Fund in 2021/22. The most significant are implementing a review of the Pension Section processes following a new structure within the Pension Section from January 2021, managing and reducing employer risk, and the implementation of the McCloud remedy.

7. The key points are detailed in points 1, 3 and 5. The business plan is attached as Appendix A.

Pension Fund Budget

8. Is it important to note the Pension Fund budget is independent of Leicestershire County Council's budget and its finances are managed separately. The Director of Corporate Resources has reviewed the proposed Pension Fund budget independently taking into account the full need of the service. In the Hymans Good Governance Phase 2 report two of the proposals state;
 - Each administering authority must ensure their Committee is included in the business planning process. Both Committee and the LGPS senior officer must be satisfied with the resource and budget allocated to the deliver the LGPS service over the next financial year.
9. Given this, Officers also wish to share this with the Local Pension Board.
10. Each administering authority must give proper consideration to the utilisation of pay and recruitment policies, including appropriate market supplements, relevant to the needs of their pension function. Administering authorities should not simply apply general council staffing policies such as recruitment freezes to the pensions function.
11. The spend controls currently in place for the County Council do not apply to the Fund, although officers are mindful of the need to manage costs to minimise the financial burden on scheme employers.
12. The current budget is a one year budget but the projected estimated amounts have been included for 2022/23 and 2023/24. The 2021/22 budget compared to 2020/21 is summarised below and is sufficient to meet the Fund's statutory requirements.

Budget Heading	2020/21	2021/22	2022/23	2023/24
	£0	£0	£0	£0
Investment Management Expenses (split into three areas)				
o Management	24,000	25,400	26,700	29,100
o Transaction	8,920	9,810	10,740	11,720
o Performance	5,000	5,490	6,020	6,570
Sub Total	37,920	40,700	43,460	47,390
LGPS Central costs (Governance, operator running costs, product)	993	1004	1007	1052
Staffing	1,300	1,400	1,470	1,540
IT costs	500	500	510	520
Actuarial costs	150	150	400	150
Support Services	400	400	410	420
Total	41,263	44,154	47,257	51,072
% of assets under management	0.91%	0.89%	0.87%	0.86%

13. The fund holds no reserves and has no capital expenditure planned.
14. The total budget being requested for approval in 21/22 is £44.2 million. A breakdown of the expenses is set out below.

Investment Management Expenses

15. Investment Management Expenses have been split into three sections, management fees, transaction costs and performance fees. These have been compiled using historical data of expenses by category received from the Fund's investment managers using a third party. There will be deviations from these numbers given the historical nature of the analysis and changes within fee structures and changes of investment manager. For example, reduced investment manager fees, as a direct or indirect result of asset pooling.
16. The 2021/22 investment management expenses are an estimate and will be largely subject to investment market returns given many fees are charged on assets under management. The Fund has assumed a prudent long-term investment return for the purpose of this budget estimate based on the most recent estimate of Fund returns from the investment consultant.
17. The breakdown on investment fees is shown below for current year 20/21 and 21/22:
- i. Management fees £24.0 million rising to £25.4 million in 21/22 – Are paid to investment managers based on a percentage of the assets under management. The figure includes £0.2 million in the current year rising to £0.6 million in 21/22

payable to LGPS Central for the sub funds the Fund is invested in and advisory services. This is the largest part of the total cost but as previously mentioned is highly dependent on investment returns.

- a. Pooling may reduce management fees where the Fund is moving from a similar strategy with an external manager. For example, the Fund moved from an emerging market debt manager to a Central fund which reduced management fees by c50bps pa on a c£100m investment. There are one off costs for transitions to be considered but in this particular case the costs are paid for within a year by the estimated savings in management fee. The Fund is also interested in a number of future central investment products that could potentially reduce costs further.
 - b. It is worth noting that in some cases the Fund will be moving Fund investments in order to meet its agreed asset investment allocation which takes into account expected returns. In the last year the Fund transitioned funds into a Central product that had other investment benefits as outlined by the due diligence undertaken but had marginally higher management fee.
- ii. Transaction costs £8.9 million rising to £9.8 million in 21/22 – Contain costs relating to trading within the fund whilst attempting to achieve the funds mandate. The increase is relation to this cost being linked to assets under management, a similar proportion of the forecasted 20/21 transaction costs is carried into future years.
 - iii. Performance fees £5.0 million rising to £5.5 million in 21/22 - some investment managers have performance fees built into the agreed mandates which are paid once a performance hurdle is achieved. This estimate can be highly variable given the Fund would not expect meaningful performance fees when general market returns are depressed. The Fund has assumed a similar proportion of performance fees to assets under management.

LGPS Central costs oversight, governance and product development

18. The budget for LGPS Central and costs borne to the Fund, concerning oversight, governance and product development have not yet been approved. The Shareholder meeting is scheduled for February 10th 2021. This request for budget approval is based on provisional estimates that could change.
19. The Fund's expected share of costs for 21/22 has been estimated at £1.0 million. The governance costs are split equally between the eight local authorities. Operator running costs are split based on assets under management and product development costs are allocated based on products that our Fund has expressed an interest in being developed. As time progresses and more assets are managed by Central the level of product development costs will decrease.

Staffing

20. The Pensions Administration staffing budget covers staffing related costs for 33 full time equivalent staff. This includes initial extra resource to work on McCloud.
21. McCloud remedy remain unknown and once greater certainty is confirmed the Pensions Manager will review staffing requirements in this area.
22. 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's valuation.

IT Costs

23. Following a full tender process, 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.
24. The cost of the system was detailed in the tender and annual costs will remain targeted at the current £500,000 each year, increased for inflation.

Actuarial Charges

25. Actuarial charges are budgeted as £150,000 each year but increases to £400,000 in 2022/23 which is Fund valuation year.
26. Officers have started a tender of actuarial services and this should be completed in 2021/22.. Costs have formed part of the tender evaluation.

Support Services

27. 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 the Fund's legal costs.
28. The improvement project may suggest differing options for the provision of support services.

Budget Summary

29. Over 90% of the budget is spent on investment manager related expenses. Given that most investment manager expenses are based on a percentage of assets under management any increase in asset values, for example an increase in stock market/equity returns, will result in higher management fees paid in total.
30. Investment management costs can therefore be volatile and are likely to be higher than budgeted if investment performance exceeds the assumptions. Therefore, the costs detailed in the report could significantly change.

Recommendation

31. It is recommended that the Board notes Business Plan and proposed Pension Fund budget for 2021/22.

Equality and Human Rights Implications

None

Appendix

The Pension Section's Business Plan 2021/22

Officers to Contact

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