



LOCAL PENSION COMMITTEE 10 SEPTEMBER 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PENSION FUND – BUSINESS PLAN AND BUDGET UPDATE 2021/22

Purpose of the Report

1. The purpose of this report is to update the Committee on the Pension Section's Business Plan and Pension Fund's 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 (SAB).
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 2021/22 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 were submitted to the Committee for approval on 26 February 2021, following consideration by the Local Pension Board on 8 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 financial year.
6. Updates regarding the strategic asset allocation and responsible investing are provided to the Local Pension Committee on a quarterly basis with standalone papers.
7. Is it important to note the Pension Fund budget is independent of the 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 LGPS senior officer must be satisfied with the resource and budget allocated to the deliver the LGPS service over the next financial year.

Business Plan

8. The previously approved Pension Section's Business Plan details the main changes planned for 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. An update on these areas are detailed as follows:-
 - Review of pension section processes: The review of processes has primarily concentrated on the following areas, Member self-service with the retirement process now available for members to complete online, postage and printing via an ongoing project to move this work to the Council's Central Print Service, thereby assisting with home working. Officers are also engaged on reviewing how members claim payment of benefits and enhanced checks to mitigate the potential from fraudulent claims. A new KPI has been developed to monitor the take up of member self-service.
 - Managing and reducing employer risk: A large area of work is ongoing. A review of the current bonds and guarantors has been completed and work is ongoing to reinstate or introduce revised bonds where necessary. A new Fund policy on employer risk has been developed. Officers have implemented a new system EPIC, for managing and controlling employer risk, and this goes live in September 2021.
 - Implement the McCloud remedy and cost cap implications: The national McCloud remedy remains unresolved for the LGPS, however Officers have continued to request the missing employer data (hours) from the employers in anticipation of the ultimate outcome. Employers are working at submitting this data, and some data has been loaded into the Pension Sections test system, prior to loading the data into the live system.

Pension Fund Budget

9. The current budget covers the financial year 2021/22 with projected estimates out to 2024/25. The 2021/22 budget is compared to 2021/22 current forecasts and is summarised in the table below. There is a chance that the budget for 2021/22 will be exceeded, this is covered later in the report.
10. The forecast for 2021/22 has been updated based on latest estimates of investment returns, LGPS Central costs and costs to run the Pensions section. In addition, a 2024/25 forecast cost has been added since the February 2021 paper.

Budget Heading	2020/21	2021/22	2021/22	2022/23	2023/24	2024/25
	Actual £'000s	Budget £'000s	Forecast £'000s	Forecast £'000s	Forecast £'000s	Forecast £'000s
Investment Management Expenses (split into three areas)						
o Management	23,284	25,400	25,600	27,900	30,500	33,100
o Transaction	7,071	9,810	7,760	8,490	9,250	10,060
o Performance	13,241	5,490	10,900	11,920	13,000	14,130
Sub Total	43,595	40,700	44,260	48,310	52,750	57,290
LGPS Central costs (Governance, operator running costs, product development)	993	1004	906	891	916	942
Staffing	1,202	1,400	1,400	1,470	1,540	1,615
IT costs	425	500	500	510	520	530
Actuarial costs	77	150	150	400	150	150
Support Services / other	451	400	400	410	420	430
Total	46,743	44,154	47,616	51,991	56,296	60,957
% of assets under management	0.99%	0.89%	0.92%	0.92%	0.91%	0.91%
Average assets under management in year	4,709,355	4,961,124	5,168,369	5,652,630	6,163,524	6,702,518

11. Actual investment managers costs used for 2020/21 are taken from investment manager standard cost submission templates.

- i. The split of management, transaction and performance costs are based on individual manager submissions. Only one manager required estimates to be used. Investment manager costs are slightly higher than budget owing to higher assets under management (AUM) than assumed when the budget was originally set. Investment manager fees are forecast to be higher than the budget driven.
- ii. Investment management expenses are forecast to be about £3.5m higher than budgeted. Of this performance costs are forecast to be higher than the fund would usually see. The difference to the budgeted performance costs figure is due to using the 2020/21 actual performance costs and estimating 2021/22 costs. The 2020/21 actual costs were far higher than the year before due to market performance in the year to March 2021. Applying a downward adjustment based on year on year relative market performance arrives at an estimated performance fee of £10.9m. The Fund has seen volatile performance costs over the last two years in line with market returns with under £1m paid in the year ending March 2020 and over £13m in the year ending March 2021. This volatility makes budgeting of performance fees difficult.
- iii. For future years, investment management expenses in total are forecast to increase. They are highly dependent on market returns with the performance fee aspect especially variable for reasons explained above. Management fees will rise as AUM is expected to rise. Variations in management fees is dependent on changes in the strategic allocation and therefore would be expected to be relatively stable given no large changes to more expensive strategies.

- iv. Performance fees have been forecast to rise from £10.9 million to £11.9 million in 21/22, this is because 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. Performance fees in 20/21 were higher than anticipated based on market performance during the year 20/21. As a result the Fund has assumed a somewhat elevated performance fees to be paid in 21/22 and future years.
 - v. AUM have been estimated to grow at 5.5% per annum plus an estimate for net contributions which is the sum of employer and employee contributions less pensions and lump sums paid. As the assets under management increase the pounds value of investment managers fees will increase.
12. Updated LGPS Central (Central) costs for the year 21/22 and onwards are based on the change in transfer pricing. The reduction to budget is due to a change in the transfer pricing policy of Central. Shareholders have voted to reduce the mark-up charged to partner funds from the start of 21/22 which translates into lower charges for the partner funds.
- a) For the purposes of the 22/23 budget officers have increased the LGPS cost by a prudent 3% per annum from the current years forecast to reflect cost inflation in running the company. Any future transitions to Central will increase the costs paid. The Fund has not assumed transfers to Central until they are approved by Committee.
 - b) Product development costs estimates have been reduced from 22/23 to reflect fewer opportunities for the Fund to transition to.
 - c) The budget for Central and costs borne to the Fund, concerning oversight, governance and product development are included within this section.
 - d) The Fund's expected share of costs for 21/22 has been estimated at £0.9 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. This has been reflected in the overall Central forecasted costs.
13. As the Fund grows, more assets are pooled, and head office costs are spread over a larger Fund value, the costs of running the Fund should reduce when calculated as percentage of the total Pension Fund value.
14. The fund holds no reserves and has no capital expenditure planned.

Recent transitions

15. Pooling may reduce management fees where the Fund is moving from a similar strategy with an external manager. See below a summary of the last four Central products the

Fund has invested in. Two of the four transitions were funded by existing cash and the Fund did not previously have an allocation to investment grade credit or multi asset credit. There are one off costs for transitions to be considered which can have a wide cost range based on the prevailing market conditions and types of investment being transitioned. In the case of the Emerging Market Debt transition the saving in fees was significant with Central able to negotiate competitive rates with managers.

Calendar Quarter	Transition	Amount £m	Savings
Q1 2020	Cash to Central Investment grade credit	£100m	Not applicable
Q4 2020	LGIM passive funds to LGPS Central Climate fund	£700m	Circa 1 bps pa saved on transition. Central's management fee for 20/21 was 4.8 bps.
Q4 2020	Ashmore EMD to Central EMD fund	£100m	Net saving of c55 bps pa on manager fees.
Q2 2021	Cash to Central MAC fund	£200m	Not applicable

Pension section costs summary

Staffing

16. The Pensions Administration staffing budget covers staffing related costs for 33 full time equivalent staff. This includes initial extra resource to work on McCloud.
17. McCloud remedy remains unknown and once greater certainty is confirmed the Pensions Manager will review staffing requirements in this area. Whilst no national deadline has been set for the conclusion of the McCloud exercise in the LGPS, it is now widely accepted the exercise is administratively challenging and could take a number of years to complete.
18. 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 last triennial valuation.

IT Costs

19. 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. As part of the review of processes, the Pensions Manager is working with the pension administration provider, to implement more automation when a member retires and moves to pensioner payroll. This is designed to reduce risk of error and improve controls.
20. 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. However, because the McCloud remedy remains unknown, and system changes are required to compare

members pension benefits, there is an expected increase in system costs in 2022/23. The Pensions Manager will monitor this.

Actuarial Charges

21. Actuarial charges are budgeted as £150,000 each year but increases to £400,000 in 2022/23 which is a Fund valuation year.
22. Officers have completed a tender of actuarial services, the new contract runs to 2026. Hymans Robertson were awarded the contract.

Support Services

23. 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.

Budget Summary

24. The current forecast is approximately £3.4m over the budget. This is almost entirely due to setting the performance fee budget lower based on 19/20 actual spend.
25. 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 absolute management fees and for some managers performance fees paid.
26. Investment management costs can be volatile and if general stock market returns are lower in the second half of the year the investment management fees could be lower than forecasted. Conversely if returns improve to the end of the year then management fees and performance fees could be higher than forecasted.

Recommendation

27. It is recommended that the Committee note the Business Plan and latest monitoring position against the Pension Fund budget for 2021/22.

Equality and Human Rights Implications

None

Background Papers

[26 February 2021 Local Pension Committee - Business Plan and Budget 2021/22](#)

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