



LOCAL PENSION BOARD

16 FEBRUARY 2022

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PENSION FUND – BUSINESS PLAN AND BUDGET 2022/23

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 budget for 2022/23.

Background

2. To demonstrate good governance the Pension Fund Budget and Business Plan are presented to the Board for consideration. This approach was introduced for the 2021/22 Budget and Business Plan.
3. The 2022/23 Business Plan and Budget will then be submitted to the Committee in March 2022 for approval 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

4. The Pension Section's Business Plan details the main changes that impact on the Pension Fund in 2022/23. The most significant are implementing a solution for the national Pensions Dashboards, implementation of McCloud, developing new bulk processes to assist with pensions administration and implementing the Pension Regulator's new Code of Practice. 31 March 2022 is the Fund's valuation date so a significant amount of time and resource will be working on valuation throughout 2022/23.
5. The key points are detailed in points 1, 4, 5, 6 and 10 within the Pension Administration business plan, attached as Appendix A.
6. The investments business plan covers five main areas, training, policies, asset allocation, fund valuation and reporting. The main areas of focus during the year will be developing the Fund's first Climate Strategy and ensuring it is aligned with the Strategic Asset Allocation. Full details of individual work and deliverables are included within Appendix B.

Pension Fund Budget

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 Resources, as the Fund's designated senior officer, has reviewed the Pension Fund budget independently considering the full need of the service. Whilst the Good Governance project has not been finalised, Phase 3 of the report includes the proposal;
- 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.
8. The budget is for one year (2022/23) but the projected estimated amounts have been included for 2023/24 and 2024/25. The 2021/22 budget and forecast are included for comparison purposes. The 2022/23 budget is expected to be sufficient to meet the Fund's statutory requirements.

Budget Heading	2020/21 Actual £'000s	2021/22 Budget £'000s	2021/22 Forecast £'000s	2022/23 Forecast £'000s	2023/24 Forecast £'000s	2024/25 Forecast £'000s
Investment Management Expenses (split into three areas)						
o Management	23,284	25,400	25,600	27,400	29,200	31,100
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	47,810	51,450	55,290
LGPS Central costs (Governance, operator running costs, product development)	993	1004	972	986	969	1003
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	47,682	51,586	55,049	59,018
% of assets under management	0.99%	0.89%	0.92%	0.91%	0.89%	0.88%
Average assets under management in year	4,709,355	4,961,124	5,168,369	5,652,630	6,163,524	6,702,518

Investments

9. The Fund holds no reserves and has no capital expenditure planned.

10. Officers will consider how to monitor performance against certain elements of the budget that are not dependent on investment performance.
11. The total budget being requested for approval is £51.6 million for 22/23. A breakdown of the expenses is set out below.

Investment Management Expenses

12. Investment Management Expenses have been split into three sections, management fees, transaction costs and performance fees. There could be deviations from these numbers given the changes within fee structures and changes of investment manager. For example, reduced investment manager fees, as a direct or indirect result of asset pooling.
13. The 2020/21 investment management expenses are an estimate and will be subject to investment market returns, however the Fund has assumed a prudent long-term investment return for the purpose of this budget estimate.
14. This estimated increase in investment management expenses from £43.6 million in 2020/21 to an estimated £44.3 million for 2021/22 is mostly due to increases in management fees due to Fund's assets under management increasing, as most investment managers charge a percentage-based fee, thus as assets under management grow, so do management fees and associated transaction fees.
 - i. Management fees (£27.4 million) – Are paid to investment managers based on a percentage of the assets under management. Officers have assumed marginally lower management fees as a percentage of assets under management (AUM) in 22/23 based on investments in Central products that have lower fees generally versus a similar product with a legacy manager.
 - ii. Transaction costs (£8.5 million) – Contain costs relating to trading within the fund by the underlying investment managers whilst attempting to achieve the funds mandate.
 - iii. Performance fees (£11.9 million) - some investment managers have performance fees built into the agreed mandates which are paid once a performance hurdle is achieved. This can be highly variable given the Fund would not expect meaningful performance fees when general market returns are depressed.

LGPS Central costs oversight, governance and product development

15. 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 22nd 2022. This request for budget approval is based on provisional estimates that could change.
16. The Fund's expected share of costs has been estimated at £0.97 million. These 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. As time has

passed the level of product development fees has reduced as the majority of Central products have been bought forward. There is likely to continue to be product development as Partner Funds have their own investment advisors with differing allocations and strategies being approved each year.

Staffing

17. The Pensions Administration staffing budget covers staffing related costs for 35 full time equivalent staff. This includes one apprentice. Staff numbers increased in 2020/21 to primarily assist on the McCloud project but to also to help with Fund employer work.
18. Whilst the final McCloud remedy remains outstanding, there is greater certainty on the outcome, so the Pensions Manager will advertise for two new permanent Pension Assistants in 2022 to help on McCloud and other administration areas. This will take place in March 2022, towards the end of the current kick-starters temporary contracts, and both will be available to apply.

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.
20. The cost of the system was detailed in the tender and annual costs remains at £500,000 each year, plus an element for annual inflation. The Pension Section purchased a new reporting tool “Insights” from the pension system provider Heywood in November 2021. Officers are currently writing reports to improve efficiency and reduce risk.

Actuarial Charges

21. Actuarial charges are usually budgeted as £150,000 each year. However, in valuation years the budget increases to £400,000 to account for the significant increase in actuarial work. 2022/23 is a valuation year so the budget is £400,000.

Support Services

22. 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

23. Over 85% 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.

24. 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 if returns exceed expectations.
25. A high level cash flow forecast is included in the table below. The Fund would expect to reduce cash in the year by around £80m to end the year 22/23 at around £100million.
26. This would be achieved through reinvestment activity in the main which would be offset by investment income (mainly infrastructure and property) and non-investment income owing to the fact the Fund collects more in employee and employer contributions than it pays in pensions.

Type of cashflow	£m	Description
Forecast Opening cash	180	Forecast opening cash position at April 2022.
Net investment activity	-172	Most mandates don't provide income distribution with reinvestment preferred whilst the Fund is cashflow positive. We are guided by managers with respect to net cashflows but these can be uncertain and as such these forecasts can have wide degree of uncertainty. The largest underweight positions are in private markets where money once committed takes time to be called. The largest two underweight positions are in infrastructure and property which will undergo a review in 2022. The outcomes of the review will take time to enact as described earlier. As a consequence of monies committed and not called and new commitment that need to be made we currently expect net outflows from private credit of £100m and infra of £35m. These will be offset by other markets such as PE where a net inflow is expected.
Management expenses	-5	These are investment management expenses paid directly by the Fund. Majority of fees are paid from the investments held with the managers.
Investment income	30	Primarily from property and infrastructure investments
Non investment cashflow	63	Employer and employee contributions exceed the benefit payments made. Only moves gradually compared to the previous year, unless a step change following the tri-annual valuation.
Currency Hedge	0	No cashflow forecast estimated given the inherent difficulty in doing so. The Fund currently has c£60m in collateral. This deemed adequate and would provide enough collateral for a 10% adverse movement in the Fund's 3 major foreign currency exposures, US Dollar, Euro and Yen. No forecast cashflow effect given no strong view on whether the Pound will strengthen or weaken over 22/23.
Change in 22/23 cash position	-84	The aim is to keep cash as low as possible by reinvesting in line with the strategic asset allocation. The use of a shorter term home where cash can be 'parked' awaiting calls from private market managers has been assumed in the calculation for net investment activity.
Forecast closing cash	96	

Recommendation

It is recommended that the Board notes the Administration and Investment Business Plans and proposed Pension Fund budget for 2022/23.

Equality and Human Rights Implications

None

Appendix

Appendix A: The Pension Section's Business Plan 2022/23

Appendix B: Leicestershire County Council Investment business plan 2022/23

Officers to Contact

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