



LOCAL PENSION COMMITTEE 18 NOVEMBER 2022

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

**PENSION FUND UPDATE – BUDGET 2022/23,
LGPS CENTRAL JOINT COMMITTEE AND ANNUAL GENERAL MEETING**

Purpose of the Report

1. The purpose of this report is to provide the Committee with an update regarding the Pension Fund Budget, LGPS Central's (Central) Joint Committee and Annual General Meetings (AGM) and other relevant matters.

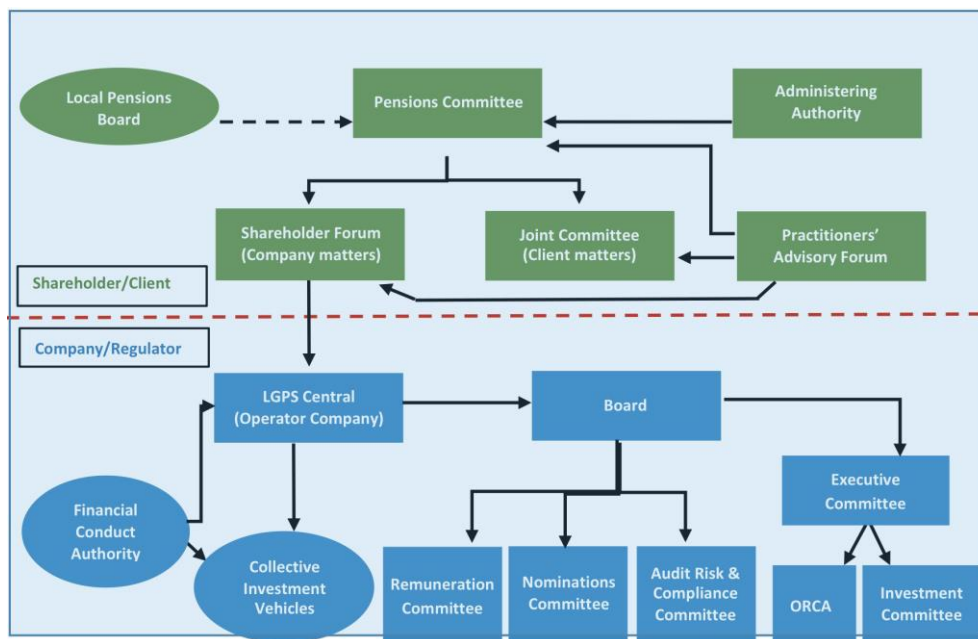
Background

2. In November 2019 the Good Governance Project in the Local Government Pension Scheme (LGPS) Phase Two report was published. This report was produced by the working groups for the consideration of the Scheme Advisory Board (SAB).
3. The report includes several proposals on how to improve governance in the LGPS. The favoured option arising from 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.
4. To demonstrate good governance the Leicestershire Pension Fund's Budget and Administration and Investment Business plans are presented to the Local Pension Board for consideration prior to submission to the Local Pension 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. This approach was first introduced for the 2021/22 Budget and Business Plan.
5. It is 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 needs 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.

6. The Local Pension Board considered the business plan and budget proposals at its meeting on 16 February 2022 and supported the 2022/23 Budget and Business Plans, the budget and business plan were approved at the 25 March 2022 Local Pension Committee.

Pooling – LGPS Central

7. Government instigated ‘pooling’ of pension funds in 2015 with the publication of criteria and guidance on pooling of Local Government Pension Scheme (LGPS) assets. Administering authorities formed their own groups and eight asset pools were formed, which are now all operational. The scale of each pool gives significant buying power in the investment market, that would not normally be accessible to funds.
8. The Leicestershire Pension Fund (Fund) is a stakeholder from two different perspectives:
- a co-owner of the company (shareholder) and
 - as a recipient of investment services
9. These interests are managed through the Shareholders Forum and the Joint Committee as well as Leicestershire Pension Fund’s Funding Strategy Statement, Investment Statement Strategy and Conflict of Interest Policy



10. The Joint Committee deals with the ‘Investor’ functions related to Fund’s investment in the collective investment vehicles. The Joint Committee meets twice a year. It is comprised of eight members, representing each of the partner funds. These representatives may be different to those on the Shareholders’ Forum, dependent on the authority. This is a public forum for Councils within the pool to receive oversight of the delivery of the objectives of the pool, the delivery of client service, the delivery against the LGPS Central business case and to deal with common investor issues.
11. The Joint Committee provides assistance, guidance and recommendations to the individual councils, taking into consideration the conflicting demands and interests of the

participants within the pool. The Joint Committee does not have delegated authority to make binding decisions on behalf of the participating councils.

Joint Committee update 23 June 2022

12. The meeting was held virtually via MS Teams on the 23rd June 2022. The agenda and associated documents are available on the Cheshire Pension Fund website who clerk the meeting. <https://www.cheshirepensionfund.org/members/about-us/how-we-manage-the-fund/governance-structure/pfc/>
13. The Fund is represented at the Joint Committee by Councillor Barkley (Chairman of the Local Pension Committee), who is the Fund's LGPS Central shareholder representative. Other attendees include other partner funds who are shareholder in LGPS Central, a scheme member representative, partner fund officers and employees from LGPS Central.
14. A number of public questions had been received prior to the meeting which were read out and responded to by the Clerk on behalf of the Committee.
15. The risk register was reviewed noting that the register relates to the Investment Pool in its widest sense and is not a reflection of the risk assessment of either LGPS Central or individual Partner Funds.
16. Members received a presentation from the Scheme Advisory Board (SAB). The SAB representative highlighted several issues affecting LGPS pension funds which are anticipated to be introduced by the Government during the next year, as well as some key ongoing issues.
17. An update from the Cheshire Pension Fund was delivered on behalf of all Partner Funds and covered:
 - a. Partner Fund involvement in discussions over several months about LGPS Central's strategic business plan and budget for 2022/23 which had culminated in the company's business plan and budget being approved by the shareholder representatives at the company AGM in February 2022.
 - b. The Investment Working Group had continued its role working with LGPS Central to develop new investment products to meet the needs of the partner funds, resulting in five new products including a Global Sustainable Equity fund with an initial investment of just over £1 billion from four partner funds.
 - c. The Investment Working Group had also regularly reviewed the strategic asset allocations of each partner fund to ensure that future requirements are fed in properly to the product development programme.
18. Members received a presentation from LGPS Central on the company's investment and Client Key Performance Indicator (KPI) performance in the period to September 2021.

19. In relation to investments underperforming investment funds, LGPS Central explained that the Emerging Market fund had provided an absolute return but had been behind its benchmark due to a certain degree by the Russian sanctions causing Russian investments to be priced to zero and the fact that the fund had greater Russian weighting than the benchmark.
20. There was discussion about recruitment and retention, which was seen as the key concern for the LGPS Central Board. The Central Chairwoman and Chief Executive Officer (CEO) explained that staff turnover was currently high and the company was reviewing how to address this. The problem had been made more challenging by the pandemic as remote working is more wide-spread and people can work for London or Edinburgh investment companies without having to be located in those cities, so LGPS Central has more competition when recruiting.

LGPS Central AGM

21. LGPS Central held their AGM on the 27 September 2022 at their office in Wolverhampton. Shareholders and partner fund officers were invited to attend. The Fund's representative at the meeting was Mr Barkley, Chair of the Local Pension Committee.
22. Minutes from the meeting have not been circulated at the time of writing this paper but in brief the following was presented:
- a. A report from the Chair of Central covering, the annual report on the governance of the Company and non-executive director succession and board continuity.
 - b. Committee updates from each non-executive director relating to, audit and risk, remuneration and nomination.
 - c. A presentation from the CEO covering a review of past years activity and performance including a forward look.
 - d. A presentation from the deputy CEO covering the financial position of the company including regulatory capital.
23. A number of resolutions were tabled which were all approved, these included:
- a. Re-election of executive and non-executive directors
 - b. Adoption of Company Report and Accounts for the year ended 31 March 2022
 - c. Re-appointment of Deloitte LLP as external auditor of the Central
 - d. Authorisation of the Board to agree the external Auditor's remuneration

Pension Fund Budget

24. The current budget covers the financial year 2022/23 with projected estimates out to 2024/25. A summary of the budget presented at the 25 March 2022 Local Pension Committee is shown below, with additional columns for the 21/22 actual costs and 22/23 forecast costs.

Budget Heading	2021/22	2022/23	2022/23	2023/24	2024/25
	Actual £'000s	Budget £'000s	Forecast £'000s	Forecast £'000s	Forecast £'000s
Investment Management Expenses (split into three areas)					
o Management	23,146	27,400	24,708	26,942	29,298
o Transaction	5,961	8,490	6,363	6,939	7,545
o Performance	9,856	11,920	18,400	10,000	10,000
Sub Total	38,963	47,810	49,472	43,880	46,843
LGPS Central costs (Governance, operator running costs, product development)	995	986	1050	1014	1065
Staffing	1,473	1,470	1,470	1,540	1,615
IT costs	448	510	510	520	530
Actuarial costs	163	400	400	150	150
Support Services / other	492	410	510	420	430
Total	42,534	51,586	53,412	47,524	50,633
% of assets under management	0.77%	0.91%	0.94%	0.77%	0.76%
Average assets under management in year	5,559,960	5,652,630	5,652,630	6,163,524	6,702,518

25. Actual investment managers costs used for 2021/22 are taken from investment manager industry standard cost submission templates which, with updated guidance on populating, have produced more accurate costs for embedded management fees and transaction costs. The reduction in fees as a percentage of assets under management in 2021/22 is as a consequence of lower performance fees (£3.4m lower) compared to the prior year and a 18% higher average assets under management between 2020/21 and 2021/22.

- i. The split of management, transaction and performance costs are based on individual manager submissions. The resulting costs are lower than anticipated when setting the 22/23 budget. The 22/23 forecast has subsequently been reviewed taking into account the more up to date information available. A similar update has been applied to the forecasts for 23/24 and 24/25.
- ii. Total investment management expenses are forecast to be in the region of £1.5m higher than budgeted with reduction across two areas, management fees and transaction fees and an increase in performance fees. The difference to the budgeted performance fees figure is due very good investment performance from a particular manager who has seen record breaking performance to October 2022. There is a chance that if performance for the managers strategy reverses by March 2023, then performance fees would be lower than forecast and as such there is a high degree of variability in the performance fee forecast. The Fund has seen volatile performance costs over the last two years which are in line with market returns with c£10m in the year ending March 2022. This volatility makes budgeting of performance fees difficult considering the time left to the end of the financial year

end. A conservative estimate of £18.4m has been included in 23/23 followed by £10m in each of the 23/24 and 24/25.

- 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. The absolute level of management fees will rise as assets under management (AUM) is expected to rise over time. Variations in management fees is dependent on changes in the strategic allocation and therefore would be expected to be relatively stable if there are no large changes to more expensive strategies.
- iv. Performance fees have been forecast at £18 million in 22/23, this is because some investment managers have performance fees built into the agreed mandates which are paid once a performance hurdle is achieved. The previous year included good performance from mandates containing performance fee provisions and as such £9.9m was paid in 21/22.

This performance fee estimate can be highly variable given the Fund would not expect meaningful performance fees when general market returns are depressed. At the time of setting the budget for 22/23 markets were far more stable and as such a prudent estimate was included within the 22/23 budget based on the prior year forecast.

- v. AUM has been estimated to grow over time based on a 5.5% pa investment growth assumption 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 whilst the value a percentage of the Fund reduces all other things being equal.

26. Updated LGPS Central (Central) costs for the year 22/23 is forecast at £1,050k. The budget for Central and costs borne to the Fund, concerning oversight, governance and product development are included within this section. This is an increase from the £986,000 budget and £995,000 21/22 actual costs. The increase to budget is broadly spread across governance, running costs and product development costs at Central. Central costs amount to c2 basis points (two one hundredths of one percent) of the value of the Fund.

- a) The forecast Central costs for future years has been revised based on the 22/23 forecast with a revised inflation estimate of 5% which has been increased from the 3.5% estimate that was used for the March 2022 estimate. The effect of these changes is an increase in Central costs from the budget for 22/23 of £64,000 and £106,000 over the subsequent two years.
- b) Any future transitions to Central will increase the costs paid. The Fund has not assumed transfers to Central until they are approved by Committee.
- c) Product development costs estimates have been reduced from 23/24 to reflect fewer opportunities for the Fund to transition to.

- 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.

27. 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.

28. The fund holds no reserves and has no capital expenditure planned.

Pension section costs summary

29. The Pension Administration functions forecast is now £2.9m which is c£100,000 higher than budget. A more detailed review of central recharges has resulted in the increase which is usually confirmed at year end.

30. The Pensions Administration staffing budget covers staffing related costs for 35 full time equivalent permanent staff.

31. Whilst the final McCloud remedy is outstanding, there is much greater clarity on the requirements. The Pensions Manager has reviewed resource and recruited two additional temporary Pensions Assistants to assist on reviewing and inputting the required data for the McCloud project.

32. Within the percentage rate that employers pay there is an allowance for administration expenses. From April 2023 this will be 0.4% and increase of 0.1% from the 2019 Valuation.

IT Costs

33. Following a full tender process, the Pension Section invested in a 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 an ongoing review of processes, the Pensions Manager is working with the pension administration provider, to drive more self-service. This is designed to enhance the customer experience and improve efficiency.

34. The cost of the system was detailed in the tender and annual costs will remain targeted at the current £510,000 each year, increased for inflation.

Actuarial Charges

35. Actuarial charges are budgeted as £150,000 each year but increases to £400,000 in 2022/23 which is a Fund valuation year.

Support Services

36. Support Services are made up of strategic financial and operational finance recharges from East Midlands Shared Services, for example, for providing the pensioner payroll service. The recharges also include legal, internal audit, central print and democratic services costs.

Budget Summary

37. The current forecast is approximately £1.8m above the budget and £10.8m above 21/22 actual costs. The increase versus budget is largely due to exceptional performance from a manager during the year to date.

38. About 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 change in asset values, for example an increase/decrease in stock market/equity returns, will result in changes absolute investment management fees and for some managers performance fees paid.

39. 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.

Recommendation

40. It is recommended that the Local Pension Committee notes the budget, and matters considered at the recent meetings of the LGPS Joint Committee and Annual General Meeting.

Equality and Human Rights Implications

None

Background Papers

[Local Pension Committee Business plan and Budget 25 March 2022](#)

Officers to Contact

Mr C Tambini, Director of Corporate Resources

Tel: 0116 305 6199 Email: Chris.Tambini@leics.gov.uk

Mr D Keegan, Assistant Director Strategic Finance and Property

Tel: 0116 305 7668 Email: Declan.Keegan@leics.gov.uk

Mr B Kachra, Senior Finance Analyst - Investments

Tel: 0116 305 1449 Email: Bhulesh.Kachra@leics.gov.uk