



## **LOCAL PENSION COMMITTEE - 18 NOVEMBER 2022**

### **REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

### **FUNDING STRATEGY STATEMENT, INVESTMENT STRATEGY STATEMENT AND INVESTMENT ADVISOR OBJECTIVES**

#### **Purpose of the Report**

1. The purpose of this report is to inform the Committee of the key changes in the Leicestershire Local Government Pension Scheme (LGPS) draft Funding Strategy Statement (FSS), the Investment Strategy Statement (ISS) and the investment advisor objectives for Hymans Robertson.

#### **Background**

##### **Funding Strategy Statement**

2. Each LGPS administering authority has a statutory obligation to have an actuarial valuation carried out every three years and all Funds in England and Wales have a valuation carried out as of 31 March 2022.
3. The major purpose of the actuarial valuation is for the actuary to set employer contribution rates for a three-year period, that commences one year after the valuation date (i.e. for the period 1 April 2023 to 31 March 2026). To set these contribution rates the actuary must take account of a large number of factors, most of which are assumptions of what will happen in the future. The draft assumptions for use at the 31 March 2022 valuation were presented to the Local Pension Committee on 10 June 2022.
4. In addition to the assumptions that remain under review, Officers must review and update the Fund's Funding Strategy Statement (FSS). The FSS underpins the Fund policies and includes a table detailing the Fund's framework for setting contribution rates for differing employer groups.
5. As part of the valuation process, employers must be made aware of the FSS and any key changes, and a consultation must take place with the employers. A timetable of the valuation process is included in the report.

### **Funding Strategy Statement**

6. The Actuary and Fund Officers work collaboratively on the Fund's FSS. Officers have used this opportunity to review the "style and presentation" of the FSS, with the intention of making this easier to navigate for all parties.
7. The new style FSS, attached as Appendix A to this report, comprises two main sections: a core section and four appendices. The "core section" covers the following:
  - a. Welcome to the FSS
  - b. Calculation of employer contributions
  - c. Additional contributions that may be payable
  - d. Calculation of assets and liabilities
  - e. Employers joining the Fund
  - f. Bulk transfers of staff
  - g. Employers leaving the Fund
  - h. Statutory reporting

Appendices to the core FSS, generally relate to Leicestershire Fund policies that cover the following:

- Regulatory framework
  - Roles and responsibilities
  - Risks and controls
  - Assumptions
  - Pass-through policy
  - Academies policy
  - Contribution reviews
  - Cessation policy
8. Much of the information in the new style draft FSS remains the same as the Fund's previous version, but for ease the key changes are highlighted in yellow in the document. These are detailed as follows:
    - a. Contribution reductions (Point 2.3). This sets out the Fund's proposal on how to deal with employer rates, especially with the improved funding position since the 2019 valuation, for those well-funded employers in surplus. The concept was taken to the Local Pension Committee on the 26 November 2021 for noting, and further information will follow in the final FSS in early 2023.
    - b. Prepayment of contributions (Point 2.9). There is no change to the Fund's current approach for the prepayment of contributions, however this is now more explicit in the FSS.
    - c. Early retirement on ill-health grounds (Point 3.2). There is no change to the Fund's current approach to ill health risk mitigation, however this is now more explicit in the FSS.

- d. Risk and control – For best practice the FSS now includes a link to the Fund’s risk register (Appendix C – C1). The risk register will continue to be reviewed by Officers.
- e. Employer covenant assessment and monitoring (Appendix C – C6). There is no change to the Fund’s current approach, however this is now more explicit in the FSS.
- f. Climate risk and TCFD reporting (Appendix C – C7). This makes the Fund’s approach more explicit in the FSS.
- g. The Fund has updated the assumptions applied at cessation following an employer’s exit from the Fund (Appendix D – D5). This is a proposed change and moves away from a gilts-based cessation for employers exiting the Fund with no guarantor. Further information on this will be submitted to the Local Pension Committee.

### **Investment Strategy Statement**

- 9. All LGPS funds in England and Wales are required to have an Investment Strategy Statement (ISS). The ISS is composed in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (“the Regulations”).
- 10. The last update of the ISS was approved by the Local Pension Committee in February 2021.
- 11. A number of changes have been included for consultation within the draft ISS, the main amendments are summarised below:
  - a. Update of investment beliefs to include explicit reference to climate change presenting a material risk to financial markets. The Fund supports a transition to a low carbon economy, in line with its ambition to become Net Zero by 2050, or sooner. This is in addition to the responsible investment belief that existed previously.
  - b. Update to the 2022 strategic asset allocation (SAA) which was approved at the January 2022 Local Pension Committee. Please note that the 2023 SAA exercise is underway with the Fund’s investment advisor, the SAA is scheduled to be presented to the Pension Committee on the 20 January 2023. The ISS will then be updated with the most recent SAA before final presentation at the 3 March Pension Committee.
  - c. Introduction of a rebalancing policy within the ISS. This aims to formalise processes that invests and divests from individual investment managers in order to stay as close as possible to the approved SAA.

- i. Of note is the tolerances being proposed at asset group level (asset group refers to asset classes such as listed equity, targeted return and private equity which collectively form the 'growth' asset group)
  - ii. The tolerances by asset group will be reviewed during the 2023 SAA exercise being undertaken currently with any changes advised being proposed taken to the January 2023 Committee when the 2023 SAA will be presented. The tolerances will then be reviewed alongside the standard SAA exercise each year by the Fund's investment advisor.
  - iii. The rebalancing framework includes scope to exercise judgement given markets and individual asset classes can sometimes be more volatile than others and the Fund may want to exercise additional caution and / or due diligence before making an automatic rebalancing decision. It is noted that there will be an element of judgement that will be exercised when deciding on rebalancing, as not all eventualities can be prepared for. Examples can include extreme market movements in parts of the portfolio that mean rebalancing may not be possible or preferred.
  - iv. This formalisation and development of a framework will ensure greater control over when and how rebalancing decisions are taken.
- d. Update of the mean long term return of the portfolio to 6.5% pa from 5.5% pa previously based on the results from the triennial Fund valuation exercise. Update to the likelihood of achieving 4.4% pa investment returns to 75% versus previously an 80% likelihood of achieving 3.4% pa by the Fund's actuary.
12. Reference to the Fund's draft Net Zero Climate Strategy is included within the responsible investing section for the first time with inclusion of one of the primary aims, net zero by 2050 with an ambition for sooner.

### **Investment advisor objectives**

13. The Investment Consultancy and Fiduciary Management Market Investigation Order 2019 requires pension scheme trustees to set strategic objectives for their investment consultants before they enter into a contract or continue to receive services from them.
14. The proposed investment advisor objectives are included as an appendix to this report.

15. The annual review of the objectives has been undertaken with the main changes noted below. The previous objectives were approved at by the Committee at its meeting in the January 2022.
- a. Changes within the strategic objectives to propose advice that will, 'maintain a long term steady state of full funding going forward'. Inclusion of a suitable diversification statement taking into account the Fund's governance capacity and focus on predictable returns.
  - b. Changes within the governance objectives that include, 'advice on the actions the Fund should undertake to deliver it's Net Zero goals and other responsible investment objectives and priorities.'
16. Officers propose to commence a consultation on the ISS and FSS with employers. To assist administration, the ISS and FSS consultation will commence at the same time employers receive their indicative employer rates which is expected to be in late November 2022. The consultation will run to the 15<sup>th</sup> January 2023. Responses will be considered by officers and appropriate changes will be made to the relevant policies before presentation to the Pension Committee in March 2023.

### **Recommendation**

17. It is recommended that:
- a. The Leicestershire Pension Fund's draft Funding Strategy Statement be approved for consultation.
  - b. The Leicestershire Pension Fund's draft Investment Strategy Statement be approved for consultation.
  - c. The Fund's investment advisor's investment objectives be approved for submission to the Competition and Markets Authority.

### **Equality and Human Rights Implications**

18. There are no equality or human rights implications arising from the recommendations in this report.

### **Appendix**

Appendix A – Draft Funding Strategy Statement  
 Appendix B – Draft Investment Strategy Statement  
 Appendix C – Investment Advisor Objectives

### **Background Papers**

Report of the Local Pension Board on 17 August 2022 "Pension Fund Valuation 2022"

<https://bit.ly/3ezqB7m>

Leicestershire County Council Pension Fund Actuarial valuation at 31 March 2022

<https://bit.ly/3D5m5qS>

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