



Open Report on behalf of Andrew Crookham, Executive Director - Resources

Report to:	Pensions Committee
Date:	12 October 2023
Subject:	Pension Fund Update Report

Summary:

This report updates the Committee on Fund matters for the quarter ending 30 June 2023 and any other current issues.

The report covers:

1. Funding and Performance Update
2. TPR Checklist Dashboard and Code of Practice
3. Breaches Register Update
4. Risk Register Update
5. Asset Pooling Update
6. Annual Report and External Audit Update
7. Conference and Training Attendance

Recommendation(s):

That the Committee consider and discuss the report and agree whether any action or additional information is required.

Background

1. Funding and Performance Update

- 1.1 Over the period covered by this report, the value of the Fund's invested assets increased by £40.4m (+1.3%) to £3,066.0m on 30 June 2023.

Asset Allocation

- 1.2 Appendix A shows the Fund's distribution as at 30 June. At an asset class level, property is below its tolerance level. Funds being committed to the Border to Coast Global Property Fund will help rebalance this underweight, but this will take a period of time. Cash is overweight, as this is being used to fund expected drawdowns in property and infrastructure investments.

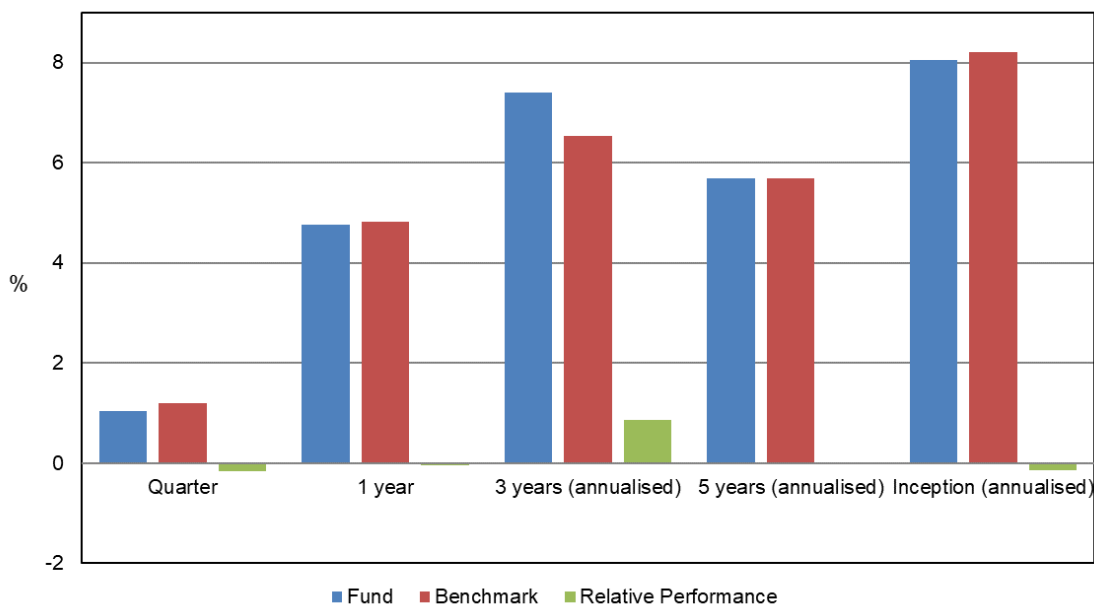
1.5 The Fund's overall position relative to its benchmark is set out in the table below.

Asset Class	Q2 2023 £m	Q1 2023 £m	Asset Allocation %	Strategic Asset Allocation %	Difference %
UK Equities	436.2	462.1	14.2	15.0	(0.8)
Global Equities	1,244.8	1,689.7	40.7	40.0	0.7
Alternatives	738.6	690.6	24.0	22.5	1.5
Property	232.5	228.1	7.6	10.0	(2.4)
Fixed Interest	334.2	344.2	10.9	11.5	(0.6)
Cash	79.8	73.0	2.6	1.0	1.6
Total *	3,066.0	3,025.6	100.0	100.0	

(* Excludes transactional cash and Border to Coast shareholding)

Fund Performance

1.6 The graph and table below show the Fund's performance against the benchmark over the quarter, one year, three years, five years and since inception. The Fund has a target to outperform the strategic benchmark by 0.75% per annum.



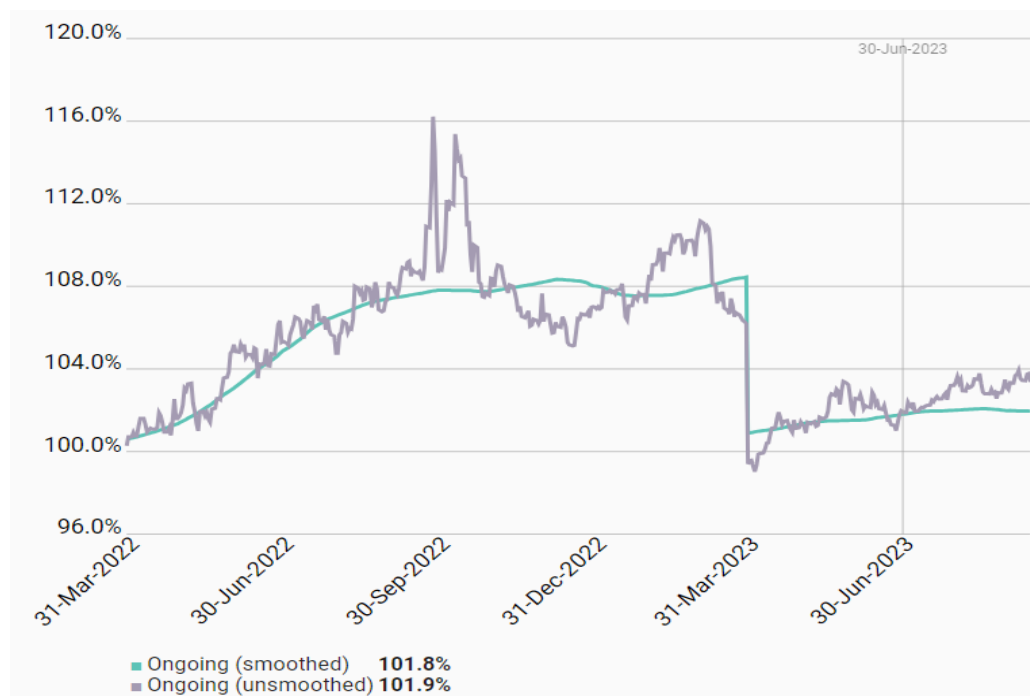
	Fund %	Benchmark %	Relative Performance %
Quarter	1.03	1.20	(0.17)
1 year	4.77	4.82	(0.05)
3 years*	7.40	6.53	0.87
5 years*	5.69	5.69	0.00
Inception**	8.06	8.21	(0.15)

*Annualised from 3yrs. **Since Inception figures are from March 1987

- 1.7 Over the quarter, the Fund produced a positive return of 1.03% (as measured by Northern Trust) but underperformed the benchmark by (0.17%). The Fund was also slightly behind the benchmark over the one year and since inception periods, but was ahead on the three and five-year periods. Details of individual managers' performance are covered at the Investment and Responsible Investment meetings of the Pensions Committee.
- 1.8 Appendix B shows the market returns over the three and twelve months to 30 June 2023.

Funding Level

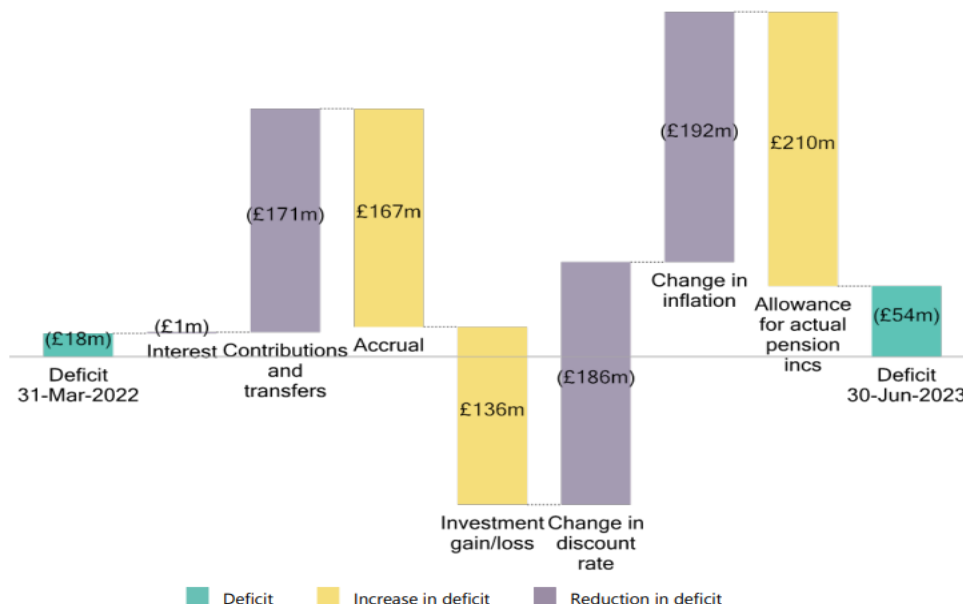
- 1.9 The funding update is provided to illustrate the estimated development of the funding position of the Lincolnshire Pension Fund from the latest formal valuation, 31 March 2022, to the current quarter end, 31 March 2023. The accuracy of this type of funding update will decline over time, as the period since the last valuation increases. This is because the funding update does not allow for changes in individual members' data since the last valuation. It is, however, a useful tool to assist the Committee to identify whether the time is right to reduce the overall risk in the asset allocation of the Fund, as it approaches a higher funding level.
- 1.10 At the last formal valuation, as at 31 March 2022, the funding level was 100.6%, with assets and liabilities measured at £3.01bn and £2.99bn respectively. Since the valuation date, the funding level has increased by 1.2% to 101.8%. The graph below shows the volatility of the changes over the period since then, both on a smoothed and unsmoothed basis.



1.11 A change to the funding basis was agreed with the Actuary in August, which was back-dated to 31 March 2023 and causes the drop in funding level reflected in the chart above at that date. The reasons and impact are summarised below:

- Since the last valuation date of 31 March 2022, there has been significant changes in the market conditions underlying the financial assumptions. In particular, there has been a significant increase in interest rates which affects the expected return of absolute return funds which form 19% of the Fund’s strategic asset allocation.
- The changes in interest rates meant that the expected return for absolute return increased considerably.
- At the same time, expected return on equities fell due to a drop in the long term expected inflation.
- This meant that if the original approach was maintained, absolute return funds would be expected to achieve significantly higher returns than equities. These target returns would be very difficult for managers to achieve.
- To maintain prudence within the valuation model and consistency of relative returns amongst all asset classes, it was agreed to change the derivation of the expected returns on the absolute return funds.
- The impact of the change is an increase in liabilities and a reduction in the funding level of around 5% as at 31 March 2023.

1.12 Over the period 31 March 2022 to 31 March 2023 the surplus, in real money, has risen from £18m to £54m. Since the valuation, contributions and transfers have been slightly greater than the accrual of new benefits. The table below shows the analysis of the change in deficit.



2. TPR Checklist Dashboard and Code of Practice

- 2.1 To assist in the governance of the Lincolnshire Fund, it assesses itself against the requirements of the Pension Regulator's (TPR's) code of practice 14 for public service pension schemes, as set out in a check list attached at appendix C. This is presented to the Committee and Board at each quarterly meeting, and any non-compliant or incomplete areas are addressed. This is seen as best practice in open and transparent governance.
- 2.2 There have been no changes since the last quarter's report. The areas that are not fully completed and/or compliant are listed below.

B12 – Knowledge and Understanding – Have the pension board members completed the Pension Regulator's toolkit for training on the Code of Practice number 14?

Amber – As set out in the Fund's Training policy, it is a mandatory requirement that all PC members complete this in addition to the PB members and provide copies of the completion certificate to the Head of Pensions. However, there has been some turnover of members in both the Board and the Committee who all have a period of six months to complete their training, therefore this should be green by January, if not earlier.

F1 – Maintaining Accurate Member Data – Do member records record the information required as defined in the Record Keeping Regulations and is it accurate?

Amber – Scheme member records are maintained by WYPF. Much of the information here and in later questions relates to the records they hold on LCC's behalf. However, as the scheme manager, LCC is required to be satisfied the regulations are being adhered to. Data accuracy is checked as part of the valuation process and the annual benefits statement process. Monthly data submissions and employer training are improving data accuracy, however there are a number of historical data issues that are in the process of being identified and rectified.

F5 - Maintaining Accurate Member Data – Are records kept of decisions made by the Pension Board, outside of meetings as required by the Record Keeping Regulations?

Grey – not relevant as we do not expect there to be decisions outside of the PB. This will be monitored.

H7 - Maintaining Contributions – Is basic scheme information provided to all new and prospective members within the required timescales?

*Amber - New starter information is issued by WYPF, **when they have been notified by employers**. This is done by issuing a notification of joining with a nomination form, transfer form and a link to the website. However, because the SLA relates to when notified, it does not necessarily mean the legal timescale has been met which is within 2 months of joining the scheme. The monthly data returns and employer training are improving this process.*

K7 – Scheme Advisory Board Guidance - Members of a Local Pension Board should undertake a personal training needs analysis and put in place a personalised training plan.

Remaining Amber – Training is a standing agenda item and opportunities are shared with the Pension Board as they arise. Pension Board members all complete a training log annually to record all training undertaken.

3. Breaches Reporting - update

3.1 The Fund and those charged with its governance have a requirement to log and, where necessary, report breaches to the Pensions Regulator. The Breaches Register attached at appendix D shows those breaches logged over the last twelve months. Since the last quarter end, one breach has been added, detailed below:

- **Late payment of contributions** – there have been some late employers over the quarter, but nothing of significance that requires reporting to TPR. A separate paper will be presented annually to the January meeting of this Committee covering this and other employer monitoring.

4. Risk Register Update

4.1 The risk register is brought to this Committee at agenda item 7, for the annual review.

5. Asset Pooling Update

Sub Funds

5.1 Work has continued with the development of the real estate funds, with the next transition for Lincolnshire expected to be into the Core Global Property fund, due to be launched later in 2023.

5.2 Since the last Committee meeting, Border to Coast has held workshops and meetings with officers and advisors covering quarterly external and internal funds, property, UK opportunities, passive funds, responsible investment and the pooling consultation.

Joint Committee Meetings

5.3 The last Joint Committee was held on Thursday 28 September 2023 and papers were shared with the Committee. The agenda items were:

- Election of Vice Chairman
- Schedule of Future Meetings
- Joint Committee Budget
- Responsible Investment Update
- Market Review

- 2030 Strategy
- LGPS Consultation
- Annual Review of UK Listed and Overseas Developed Equities
- Annual Review of Alternatives
- Annual Review of Listed Alternatives
- CEO Report
- Investment Review Quarter Ended 30 June 2023

5.4 The next meeting of the Joint Committee is being held on 28 November and papers will be shared with this Committee once they become available. Any questions or comments on the papers should be directed to Cllr Strengiel, Chairman of the Pensions Committee, who can raise them at the meeting.

Shareholder Matters

5.5 As the Committee are aware, there are two distinct roles that Lincolnshire County Council has with Border to Coast: the shareholder and the investor (or client). The Committee's role is that of investor and is represented at the Joint Committee by the Chairman of the Pensions Committee. The shareholder role is undertaken by the Executive Director of Resources and fulfils the role as set out in the Shareholder Agreement, which was recently updated following review and approved by Full Council in February 2023.

5.6 Ahead of any shareholder approvals, officers, including S151 officers, work closely with Border to Coast to ensure full understanding of the resolution, the impact of it not being approved and discuss this with the JC ahead of any resolution being sent for approval. An informal shareholder meeting is also held on the date of each Joint Committee meeting.

5.7 There were a number of shareholder resolutions at the AGM, held on 18 July, all of which were approved:

- Adoption of the Accounts for the year ended 31 March 2023
- Re-appointment of the External Auditor
- Note the Directors Outside Business Interest Policy
- Receive the Register of Directors Interests
- Approval of the extension to Ms Guthrie's term as a director of the Board to 30 September 2027
- Approval of the extension to Cllr Holtby's term as a director of the Board to 30 September 2024
- Approval of the appointment of Richard Hawkins as a new non-executive director of the Company (term to 30 September 2026)

Future Funding Model

5.8 The current funding model, as shaped by the Partner Funds prior to inception of Border to Coast, was designed to support funding both regulatory capital (as required by the FCA) and revenue and liquidity requirements throughout the initial start-up

period (expected to be c. five years). It aimed to address the following requirements over this initial build period:

- Provide the required resources to support the build of a long-term resilient and sustainable operating model, that was sufficiently flexible so as to be able to adapt to meet Partner Funds' changing needs.
- Provide an initial degree of detailed oversight of the organisation as a corporate entity by Partner Funds whilst trust and operational requirements could be refined on the basis of experience.
- Build a financing model that was based on the principal of supporting a "not for profit" operating model.
- Ensure the firm did not experience liquidity or capital issues during the build period.
- Charge Partner Funds based on their long-term strategic asset allocation (i.e. not their actual assets under management (AUM)) to ensure a fairer allocation of costs during the initial asset transition period, given that not all assets could transition at the same time.

5.9 It was always anticipated that the model would need to adapt and move to something more commonly seen in the wider industry, where charges are based on actual assets under management. Discussions have been ongoing for the last couple of years on when and what needs to change to implement a new model. The intention was for this change to be implemented from April 2025 but, at the request of Partner Funds, Border to Coast has looked to accelerate this to be ready from April 2024. Although this is a challenging delivery date, with some matters still to conclude, with Board and Partner Funds support and agreement, it is expected to be on track to meet this date. This section provides some background ahead of the final model being agreed.

5.10 A joint project group has been established, and Border to Coast has worked with Partner Funds officers to propose a new approach and outline a model for review and approval by both the Board and Partner Funds.

5.11 Further information to outline the key changes proposed, and the approvals required to implement the changes, are set out in the paragraphs below:

Why Change?

- Basing Partner Funds' costs on actual AUM makes benchmarking easier, enables easier monitoring of the total costs of investing in each sub-fund, and supports a focus on value rather than cost.
- A change could support longer-term planning and flexibility to deal with in-year events than is currently the case. However, Partner Funds have requested that the Company continues to prepare an annual budget, to enable oversight and management of any potential cost creep through this change.

What is proposed to change?

- The costs will not change in total but rather the way they are allocated between the Partner Funds. At a basic level, it is proposed that Border to Coast will stop

invoicing Partner Funds a share of the annual budget based on their long-term strategic asset allocation. Instead, an Annual Management Charge (AMC) will be applied to the investment funds which will be allocated in proportion to each Partner Fund's share of the total AUM of the fund. The AMC will reflect the actual costs incurred by Border to Coast.

- Protections will be put in place to ensure some cost certainty for Border to Coast (e.g. if the AUM significantly falls), which if not there could result in Border to Coast requiring a shareholder capital injection to meet its regulatory capital requirements. This mechanism will also support future optionality and shareholder non-compliance with the pooling guiding principles. It also avoids the need to hold extra capital and provides a means of managing liquidity requirements.

What is not proposed to change?

- The Annual Budget will continue to be approved by shareholders.
- Governance and Project costs will continue to be charged to Shareholders on a 1/11th basis.
- The charging structure for Private Markets (including Global Real Estate) will not change, which already charges on a committed assets basis.

Changes required to make this effective

- Fund documentation (the Prospectus): For each sub-fund, the ability to charge an Annual Management Charge (reflecting Border to Coast's actual costs) but subject to a capped percentage.
- Shareholder Agreement: There will be a few minor changes to the Shareholders' Agreement to enable this change to be effected. The current wording under Section 4.1 states "Each Shareholder shall pay an annual operating charge to BCPP in the amount specified in the Annual Budget in relation to services provided by BCPP as specified in the Annual Budget". However, because the AMC will be charged to the funds, it will be the investors in each fund who will now be paying these costs i.e. not the shareholders and therefore the above wording needs to be changed to remove these costs from the Annual Operator Charge.
- In addition, to protect Border to Coast from the risk of not being able to fully recover its costs (i.e. if the actual costs are greater than the AMC capped amount), the agreement will be amended to make each shareholder liable to make an equal contribution towards the shortfall.

Pension Cost Charge Agreement

- It is proposed to remove the cost sharing principles from this Agreement, with no other changes required. The Cost Sharing Principles are to be included as part of the Annual Budget process to give clarity on how Partner Funds pay for their investment related activities and their future liabilities on pensions shortfall – as is the case now.

5.12 Following the changes to the approval process for Border to Coast Governance documents agreed at the February Full Council meeting, once all changes are finalised these will be brought in full to the Pensions Committee for approval.

6 Annual Report and Accounts – External Audit Update

6.1 2021/22

At the time of writing, the Pension Fund is expected to receive the external auditor's opinion on the 2021/22 accounts and consistency opinion for the Annual Report in early October. Once received, the updated Annual Report, to include the audit opinion, will be published on the Pension Fund website. The Pensions Committee received the external auditors report on the 2021/22 accounts audit at the meeting on 1 December 2022, and there are no further matters to report to the Committee in relation to this.

6.2 2022/23

Over the summer, the unquoted holdings 31 March valuations have been received and, after review by Pension Fund Officers, have been incorporated into the Pension Fund Accounts. The total impact of these updated valuations is a £7.896m increase in asset values (across private markets, infrastructure, and property venture). At the date of preparing this paper two 31 March valuations worth £1.684m were outstanding, but no further changes will be made to the accounts as it is not anticipated that the change in value for these assets will be material.

6.3 The external auditor is still working on the 2022/23 accounts and hopes to give an opinion by the end of 2023. The planning work for the 2022/23 audit year is largely complete, as is the revenue element of the final accounts audit. The audit team is currently liaising with the pensions finance team to complete the work on the investment assets. The work appears to be progressing well and we are not aware of any issues arising that need to be reported to the Committee. The external auditors Audit Completion Report will be presented to the Pensions Committee at the January 2024 meeting.

6.4 The external auditor has also completed the required testing and procedures on the 2022 Local Government Pension Scheme triennial revaluation. No issues were identified from this work and the external auditor issued their assurance letters in August. This assurance work was required to facilitate the sign off the Pension Fund and County Council audits for 2021/22 and 2022/23.

7 Conference and Training Attendance

7.1 It is stated in the Committee's Training Policy, approved each July, that following attendance (virtual or otherwise) at any conferences, seminars, webinars or external training events, members of the Committee and officers will share their thoughts on the event, including whether they recommend it for others to attend.

7.2 There have been two conferences since the last meeting:

- The LGC Investment and Pensions Summit was held in early September and was attended by the Chairman of the Committee, Cllr Alan Briggs, Steve Larter and the

Head of Pensions. Conference notes produced by Hymans Robertson are attached at appendix E.

- The Border to Coast Annual Conference was held on 28-29 September and was attended by the Chairman of the Committee, Cllr Alan Briggs, Peter Allan, Michelle Grady and the Head of Pensions.

7.3 The Committee and officers are requested to share information on relevant events they have participated in since the last Committee meeting.

7.4 The newer members of the Committee that had not been able to attend the induction training session with the Head of Pensions received a recorded version of the training, along with slides, to enable them to undertake the training in their own time. Members are requested to notify the Head of Pensions when any training is undertaken, so that it can be logged accordingly.

7.5 Upcoming training opportunities are shared in the weekly and monthly emails and current ones are shown below. Any member wishing to attend or require more information should contact Jon Haw (Jonathan.haw@lincolnshire.gov.uk):

- LAPFF Annual Conference in Bournemouth, 6-8 December.
- LGPS Governance Conference in York, 18-19 January.

Conclusion

8. The Fund is 101.8% funded (on a roll-forward basis, following the adjustment mentioned in paragraph 1.11) as at the end of June, with an overall value of invested assets of £3,066.0m.

Consultation

a) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the Head of Pensions.

Appendices

These are listed below and attached at the back of the report	
Appendix A	Distribution of Investments
Appendix B	Market Returns
Appendix C	TPR Checklist Dashboard
Appendix D	Breaches Register
Appendix E	Conference Highlights – LGC Investment and Pensions Summit

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

This report was written by Jo Kempton, who can be contacted on 01522 553656 or jo.kempton@lincolnshire.gov.uk.