

**Open Report on behalf of Andrew Crookham  
Executive Director – Resources**

Report to:	<b>Pensions Committee</b>
Date:	<b>16 July 2020</b>
Subject:	<b>Pension Fund Update Report</b>

**Summary:**

This report updates the Committee on Fund matters over the quarter ending 31 March 2020 and any current issues.

The report covers:

1. A Funding Level Update
2. Responsible Investments
3. TPR Checklist Dashboard
4. Breaches Register Update
5. Risk Register Update
6. Asset Pooling Update
7. Investment Consultancy Services Appointment
8. Actuarial Services Appointment
9. FSS Updates
10. Conference and Training Attendance

**Recommendation(s):**

That the Committee

- 1) note the report;
- 2) approve the extension of the Investment Consultancy Services contract for an additional twelve months; and
- 3) approve the amendments to the Funding Strategy Statement.

**Background**

**1. Funding Level Update**

- 1.1 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 2019, to the current quarter end, 31 March 2020. The accuracy of this type of funding update is expected to 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 100% funding level.

- 1.2 At the last formal valuation, the Fund assets were £2,353m and the liabilities were £2,536m. This represented a deficit of £183m and equated to a funding level of 93%. Since the valuation the funding level has fallen by 10% to 83%. The graph below shows the changes to the funding level since 31 March 2019.

**Change in funding level since last valuation**



- 1.3 Over the period 31 March 2019 to 31 March 2020 the deficit, in real money, has increased from £183m to £440m. Investment returns of -5.8% over the period since the valuation has been lower than expected. In particular, there has been a drop in the value of the Fund’s assets over the first quarter of 2020 as a result of the current pandemic. The outlook for future investment returns over the next 20 years on the Fund’s portfolio of assets has fallen (from 4.0% p.a. to 3.3% p.a.), increasing the value placed on liabilities. This has been almost offset by the fall in inflation which has reduced the value of the liabilities, all else being equal. Since the valuation contributions have broadly matched the accrual of new benefits.

- 1.4 The table below shows the main impactors on the deficit.

## Overall effect

Surplus/(deficit)	£m
Surplus/(deficit) as at 31/03/2019	(183)
Contributions (less benefits accruing)	3
Interest on surplus/(deficit)	(7)
Excess return on assets	(228)
Change in inflation & expected future investment return	(25)
Surplus/(deficit) as at 31/03/2020	(440)

## 2. Responsible Investments

### Voting

- 2.1 To enable the Fund to fulfil its stewardship responsibilities as an active shareholder, the active equity managers (Invesco and Border to Coast) are required to report on their voting on a quarterly basis.
- 2.2 Appendix A presents summarised information in respect of how the Invesco have voted in relation to the Fund's equity holdings, specifically where they have voted differently to the company management's recommendation. Border to Coast has produced a more detailed proxy voting report, which is also attached in appendix B.
- 2.3 Please contact the author of this report if you wish to see full detail of all votes cast over the quarter.

### Local Authority Pension Fund Forum Membership

- 2.3 The Fund participates in the Local Authority Pension Fund Forum that has a work plan addressing the following matters:
  - **Corporate Governance** – to develop and monitor, in consultation with Fund Managers, effective company reporting and engagement on governance issues.
  - **Overseas employment standards and workforce management** - to develop an engagement programme in respect of large companies with operations and supply chains in China.
  - **Climate Change** - to review the latest developments in Climate Change policy and engage with companies concerning the likely impacts of climate change.

- **Mergers and Acquisitions** - develop guidance on strategic and other issues to be considered by pension fund trustees when assessing M&A situations.
- **Consultations** – to respond to any relevant consultations.

2.3 The latest LAPFF engagement report can be found on their website at [www.lapfforum.org](http://www.lapfforum.org). Some of the highlights during the quarter included:

- During this quarter LAPFF undertook 55 engagements with 36 companies, on issues ranging from human rights and employment standards to climate change reporting and environmental risk.
- Over the last few months, the number of banks being targeted for their lending policies on climate has increased. LAPFF stepped up its engagement with banks over their lending policies to ensure that they are aligned with Paris Agreement objectives and are undertaking lobbying in a manner consistent with these objectives. To this end, LAPFF met both with ANZ Bank and with Barclays during the quarter to encourage them along these lines.
- As part of the community engagement element of the investor tailings dam initiative, LAPFF has been liaising with community representatives over a list of high risk tailings dams in Brazil. Vale has by far the largest number of dams on the list, but Anglo American and Arcelor Mittal are also represented. Therefore, LAPFF has approached all three companies to try to gain assurances that they have taken adequate steps to prevent further tailings dam collapses. All three companies have responded positively to these requests.
- LAPFF members co-filed two resolutions with Amazon and Alphabet. Both of these resolutions were aimed at social issues. The Amazon resolution sought to involve employee representatives at board level, while the Alphabet resolution requested board level oversight of human rights risks. Both resolutions were blocked by the SEC. This outcome was disappointing but not unexpected in light of the SEC's recent consultation on shareholder resolutions. This consultation seemed to be aimed at reducing the number of resolutions that US companies receive by making it harder to file and co-file. It remains to be seen what the outcome of the consultation will be, but it is likely that the shareholder resolution route in the US will be significantly curtailed, if not abandoned altogether, in light of these developments.
- LAPFF has been partnering with Sarasin and other institutional investors in engagements with the Big Four auditing firms and Shell, BP and Total about incorporating climate appropriately in the audit process. While the engagements with the audit firms were less than encouraging, both the audit firms and the companies themselves are showing signs of movement on this issue.

- 2.4 Members of the Committee should contact the author of this report if they would like further information on the Forum's activities.

### 3 TPR Checklist Dashboard

- 3.1 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.
- 3.2 No areas have changed since the last quarter's report.
- 3.3 The Areas that are not fully completed and/or compliant are listed below.

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. Therefore 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 - Annual Training Plan of Committee shared with PB and all PB members invited to attend.*

#### **4 Breaches Reporting - update**

4.1 The Fund, and those charged with its governance, has a requirement to log and, where necessary, report breaches to the Pensions Regular. The Breaches Register attached at appendix D shows those breaches logged since recording began. Since the last quarter end, one breach has been added, detailed below:

- **Late payment of contributions** – a separate paper is presented to the Committee at paper 7, updating the Committee on all monthly employer contribution breaches over quarter (January to March).

#### **5 Risk Register Update**

5.1 The risk register is brought to this Committee at agenda item 10, therefore an update is not provided in this report.

#### **6 Asset Pooling Update**

##### **Sub Funds**

6.1 Following the transition to the Investment Grade Credit Fund in February/March, the post transition report from Analytics has been issued, and a post transition workshop has been held with Border to Coast, Blackrock, Analytics and the Partner Funds. There was one key issue of concern relating to currency hedging, which has highlighted additional controls to be put in place for future transitions, as part of the "lessons learned" process. It was also the subject of much discussion at the Joint Committee (papers of which were shared with the Committee).

6.2 The next investment is into the Multi Asset Credit (MAC) Fund, in the second half of 2020/first half of 2021. Following a delay due to the disruption in markets caused by the pandemic in March, officers are now progressing the initial investment into the appointed core MAC manager's fund ahead of the move to Border to Coast.

6.3 The transition from the UK Passive equity mandate managed by LGIM to the Border to Coast internally managed UK equity fund has also progressed. Transition costs were minimised as another partner fund was looking to exit the internal fund, and therefore holdings were able to be crossed. Officers worked closely with Border to Coast and LGIM to ensure that the transition was enacted as efficiently as possible.

6.4 Border to Coast have held a number of workshops with officers and advisors on the property offering, which will be one of the more complex transitions and will take a number of years. Further information on this will be brought to the Committee later this year.

- 6.5 Officers and advisors across the Partner Funds have continued to work closely with Border to Coast, through attendance at virtual meetings and workshops, on the development of the sub-fund products.

### **Joint Committee Meetings**

- 6.6 The papers of the 16 June JC were circulated to all Pensions Committee members. The minutes will be circulated once approved, and below are the agenda items for that meeting:

- Elections for the Roles of Chairman and Vice Chairman of the Joint Committee and nominations for the Border to Coast Board
- Joint Committee Budget
- Border to Coast Market Review
- Listed Equity Fund Performance Report
- Sterling Investment Grade Transition
- Pooling Property Assets
- Chief Executive Officer (CEO) Report

- 6.7 The elections for the roles of Chairman and Vice Chairman were held, with Cllr Tim Evans (Surrey) being appointed as Chairman for the coming year, and Cllr David Coupe (Teesside) being appointed as Vice Chairman. Cllr Anne Walsh (Tyne & Wear) was nominated as the shareholder NED, to be put forward to the Board and shareholders for approval.

- 6.8 The next JC meeting will be held on 1 October 2020 and papers will be circulated to Committee members. Any questions or comments on the papers should be directed to Cllr Strenjiel, who can raise them at the meeting.

### **Shareholder Matters**

- 6.9 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 approved by Full Council in February 2017.

- 6.10 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.

- 6.11 There was only one shareholder resolution since the last report. This was related to the merger of the Northumberland Pension Fund with the Tyne and Wear Pension Fund, which reduced the number of shareholders in

Border to Coast to eleven from twelve. The resolution enabled the redistribution of the share capital so that all eleven partner funds held equal shares following the merger. This was approved.

## **7 Investment Consultancy Services Appointment**

- 7.1 As the Committee are aware, there is currently a project underway by the Scheme Advisory Board (SAB) looking at governance across the LGPS, called the Good Governance Review, which will provide a framework for all Funds to follow. This is expected to be in place for April 2021.
- 7.2 The contract for Investment Consultancy services was awarded to Hymans Robertson in January 2014, with an expiry date of 31 December 2020. Given the upcoming guidance for governance arrangements and the potential changes that may be required, officers believe it would be useful to extend the current contract with Hymans Robertson for an additional twelve months. This would allow for a full governance review of the Lincolnshire Fund against the new requirements to be undertaken ahead of appointing a consultant.
- 7.3 In addition, the creation of the asset pools and the long term transition of all assets to Border to Coast means that the roles of the investment consultant and the independent advisor will change, therefore this extension also allows for this to be considered in the governance review.
- 7.4 Officers therefore request that the Committee approve a twelve month extension to the Investment Consultancy services contract to 31 December 2021.

## **8. Actuarial Services Appointment**

- 8.1 At the March meeting of this Committee, it was agreed that the tender process for Actuarial Services for the Fund would be carried out by a working group of officers and volunteers from the Pensions Committee. An email was sent to all members in June requesting volunteers, and the both Cllr Strengiel and Cllr Adams responded positively to the request, in addition to the Committee's Independent Advisor, Peter Jones, offering his services.
- 8.2 The working group will be working over the summer months to provide a recommendation to the Committee at the October meeting.

## **9. Funding Strategy Update**

- 9.1 The latest Funding Strategy Statement (FSS) was approved by the Committee at the March 2020 meeting. Following further discussion with the Fund Actuary since the Valuation, there are some recommended changes to the FSS. These include one major change and two minor ones. The amended FSS with the proposed changes has been sent out to employers



for consultation, and no responses have been received at the time of writing this report. The amendments are explained in the paragraphs below.

### **Major change - new transferee admission agreements**

- 9.2 As reported previously to the Committee, the LGPS (Amendment) Regulations 2018 created the new ability for admitted body employers to receive any surplus on cessation in the Fund (“an exit credit”). Prior to this any surplus was retained within the Fund, whilst the employer was required to pay any deficit due. The regulations allowing the repayment of surplus to LGPS employers came into effect on 14 May 2018.
- 9.3 Previously the nature of an employer’s participation in the Fund has not been a concern for the Fund, due to the requirement for guarantees and other forms of risk mitigation. However, the implementation of the new regulations changes the profile of risk to the Fund, as employers may not always be able to repay a deficit but the Fund will always be able to repay a surplus. Surpluses often arise as a matter of chance, based on changes in financial conditions between the date of joining and leaving the fund.
- 9.4 New transferee admitted bodies are created as a result of the award of a contract by a scheme employer. These new employers typically have a short participation period in the Fund and therefore cessation events occur frequently. Officers have worked with the Fund Actuary to consider and construct a funding model for new contractor admissions that will manage the change in the risk profile following implementation of the new regulations in a way that is “fair” to both the employer and the Fund.
- 9.5 The proposed new approach is to formalise a “pass-through” arrangement for all new contractors going forward. Under this approach the contractor pays an appropriate fixed employer contribution rate, agreed by the awarding authority and the Fund Actuary, during their participation in the Fund. At the end of the contract any funding surplus or deficit falls back to the awarding authority (who will ultimately have funded the pension contributions via the cost of the contract), and no cessation deficit/surplus is payable by/to the contractor. This arrangement is set out within the contract terms between the two parties, in a risk sharing arrangement.
- 9.6 This approach mirrors many of the arrangements that our awarding employers are currently entering into with contractors outside of admission agreements, as contractors’ demand to be protected from pension funding risk.
- 9.7 Any cessation deficit or surplus reverting to the awarding authority will be absorbed into the existing assets and liabilities of that authority and be considered as part of the funding evaluation at the next triennial valuation.
- 9.8 Under the proposed approach an individual funding position is still allocated to the admitted body, as in addition to the pass-through rate they still retain responsibility for admitted body controlled risks e.g. excessive salary growth,

early payment of benefit on unreduced terms, augmentation of benefit etc. Again, this needs to be clearly set out in any contract arrangements.

- 9.9 As mentioned in paragraph 8.1 employers have been consulted about this potential change to the funding approach, and communications will continue to ensure that pensions are considered at the beginning of any potential outsourcings or contract renewals.
- 9.10 It is not proposed to apply the changes retrospectively to existing admission agreements, but to make this the default option for any new contractor admission from September.

### **Minor amendments – Small Scheduled Bodies Pool and McCloud Treatment for Cessations**

- 9.11 The Small Scheduled Bodies pool is made up of Town and Parish Councils, who normally have very few members (often only one or two) and are pooled to spread the risk and to reduce the volatility of their contributions. Clarification has been added to the cessation calculation process of the employers in this pool, in respect of how deficits are calculated.
- 9.12 As the Committee are aware, there is no agreed remedy for the McCloud court case and how it might impact the benefit structure for members, and therefore the costs to employers. The Fund has considered how it will reflect the current uncertainty regarding the outcome of this judgement in its approach to cessation valuations. The change made is to clarify that for cessation valuations that are carried out before any changes to the LGPS benefit structure (from 1 April 2014) are confirmed, the Fund's policy will be that the Actuary will add a 1% loading to calculated liabilities for "gilts exit" cessations (where there is no guarantor). On the grounds of consistency, simplicity and pragmatism, there would be no adjustment to a cessation value where the obligations are being passed on elsewhere.
- 9.13 The Committee are asked to agree the proposed changes detailed above, namely:
- the funding strategy for new transferee admission agreements - specifically the move to a "pass-through" arrangement for new employers, with an agreed fixed contribution rate, no surplus or deficit crystallisation on cessation, and additional payments only required for employer controlled risks;
  - the clarification on cessations for the Small Scheduled Body Pool; and
  - the clarification on the approach to the McCloud impact on cessations.
- 9.14 Once approved by the Committee, the amended Funding Strategy Statement will be published to reflect the change in funding approach.

## **10 Conference and Training Attendance**

- 10.1 It is stated in the Committee's Training Policy, approved each July, that following attendance 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 recommended it for others to attend.
- 10.2 The Committee and officers are therefore requested to share information on relevant events they have participated in since the last Committee meeting.

## Conclusion

- 11 The work with Border to Coast continues and progress is underway for the next transitions into Multi-Asset Credit and UK Equities.
- 12 The Committee are requested to approve the extension of the Investment Consultant contract for one year, as explained in section 7 and the updates to the FSS, as explained in section 9.

## Consultation

### a) Have Risks and Impact Analysis been carried out?

Yes

### b) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the author of this report.

## Appendices

These are listed below and attached at the back of the report	
Appendix A	Invesco Voting Activity
Appendix B	Border to Coast Voting Activity
Appendix C	TPR Checklist Dashboard
Appendix D	Breaches Register

## Background Papers

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

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