

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

Report to:	Pensions Committee
Date:	07 January 2021
Subject:	Pension Fund Update Report

Summary:

This report updates the Committee on Fund matters for the quarter ending 30 September 2020 and any other current issues.

The report covers:

1. Funding and Performance Update
2. Responsible Investments
3. TPR Checklist Dashboard
4. Breaches Register Update
5. Risk Register Update
6. Asset Pooling Update
7. New Legislation - £95k Cap Update
8. Budget and Business Plan Update
9. Conference and Training Attendance

Recommendation(s):

That the Committee consider and note the report and approve the addition to the risk register detailed in section 5.

Background

1. Funding and Performance Update

- 1.1 Over the period covered by this report, the value of the Fund increased in value by £13.2m (+0.5%) to £2,467.6 on 30 September 2020.

Asset Allocation

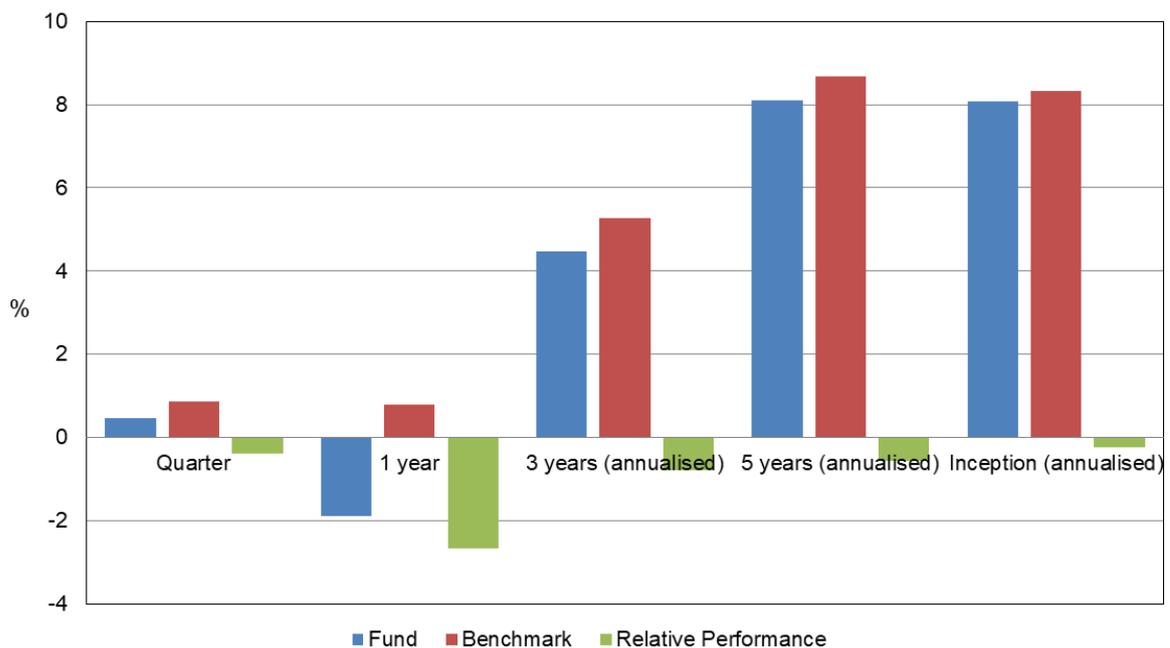
- 1.2 Appendix A shows the Fund's distribution as at 30 September. At an asset class and portfolio level no tolerance levels had been breached.

1.3 The Fund's overall position relative to its benchmark is set out in the table over the page. During the quarter the Fund transitioned £88.0m from BlackRock Bonds classified as Fixed Interest into PIMCO Multi Asset Credit classified as Alternatives.

Asset Class	Q3 2020 £m	Q2 2020 £m	Asset Allocation %	Strategic Asset Allocation %	Difference %
UK Equities	375.6	385.9	15.2	16.0	(0.8)
Global Equities	1,041.7	1,020.0	42.2	40.0	2.2
Alternatives	434.1	346.8	17.7	18.5	(0.8)
Property	196.1	195.3	7.9	9.0	(1.1)
Infrastructure	48.8	50.8	2.0	2.5	(0.5)
Fixed Interest	355.4	441.2	14.4	13.5	0.9
Cash	15.9	14.4	0.6	0.5	0.1
Total	2,467.6	2,454.4	100.0	100.0	

Fund Performance

1.4 The graph and table below shows 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	0.47	0.87	(0.41)
1 year	(1.90)	0.78	(2.68)
3 years*	4.47	5.26	(0.79)
5 years*	8.11	8.68	(0.57)
Inception**	8.07	8.32	(0.25)

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

- 1.5 Over the quarter, the Fund produced a positive return of 0.47% (as measured by Northern Trust), underperforming the benchmark by (0.41%). The Fund was also behind the benchmark over all periods including since inception.
- 1.6 Appendix B shows the market returns over the three and twelve months to 30 September 2020.

Funding Level

- 1.7 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, 30 September 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.
- 1.8 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 7% to 86%. The graph below shows the changes to the funding level since 31 March 2019.



- 1.9 Over the period 31 March 2019 to 30 September 2020 the deficit, in real money, has increased from £183m to £392m. Investment returns of 4.3% over the period since the valuation have been slightly lower than expected. The outlook for future investment returns over the next 20 years on the Fund's portfolio of assets has also fallen (from 4.0% to 3.2%), increasing the

value placed on liabilities. Since the valuation, contributions have broadly matched the accrual of new benefits.

1.10 The table below shows the main impactors on the deficit.

Surplus/(deficit)	£m
Surplus/(deficit) as at 31/03/2019	(183)
Contributions (less benefits accruing)	4
Interest on surplus/(deficit)	(15)
Excess return on assets	(28)
Change in inflation & expected future investment return	(170)
Surplus/(deficit) as at 30/09/2020	(392)

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 C presents summarised information in respect of how 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 more detailed proxy voting reports, which are attached at Appendix D (Global Equity Alpha) and E (UK Listed Equities).
- 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

- 2.4 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.

2.5 The latest LAPFF engagement report can be found on their website at www.lapfforum.org. Some of the highlights during the quarter included:

- During this quarter LAPFF undertook 38 engagements with 27 companies, on issues ranging from human rights and employment standards to climate change reporting and environmental risk. The outcomes of these engagements are shown in the company progress report, included in their quarterly engagement report.
- LAPFF, along with other investor groups, most prominently the Australasian Centre for Corporate Responsibility (ACCR), has been pushing Rio Tinto to review its corporate governance arrangements. One of the main strategies in this engagement has been to issue press releases citing LAPFF's concerns as various details of Rio Tinto's practices were revealed through a range of investigations. There has been an internal investigation led by a non-executive director on Rio Tinto's board, which resulted in the elimination of short-term bonuses for three senior executive members, including the CEO. Subsequently, the CEO and two other senior executives resigned. The Forum received significant press coverage for its support of this measure.
- Engagement to date with ArcelorMittal has led to a 30% carbon emission reduction target for its European operations by 2030, and for carbon neutrality for 2050. A follow-up meeting at the beginning of July sought commitments to global targets for 2030 and 2050. The meeting with ArcelorMittal resulted in a commitment for a group 2030 carbon emission reduction target to be disclosed in a report to be released later this year.
- The impact of deforestation on climate change is a growing concern. LAPFF has worked with other investors to push the Brazilian government to stem deforestation in the Amazon. The investor coalition drafted and co-signed a letter to the Brazilian government and held a call hosted by Storebrand to encourage better protection of the Amazon.
- At a meeting with Tesco, one objective was for the company to set out how it aimed to achieve its target of fully recyclable packaging by 2025. The meeting also discussed how the company's meat supply chain

might contribute to deforestation through its supplier JBS, and the problem of plastics in the supply chain.

- During the quarter, LAPFF representatives joined a supply chain due diligence workshop hosted by the newly independent Workforce Disclosure Initiative. Attendees discussed what companies and investors can do to improve workplace standards at supplier facilities. LAPFF also met with Andrew Adams at CCLA to discuss joining an investor coalition to promote compliance with the Modern Slavery Act. This would be in addition to the Forum's participation in Rathbone's engagement with companies that fail to adhere to Modern Slavery Act requirements.
- LAPFF has submitted a number of consultation responses during the quarter. One was a consultation on the future of audit. Of note is that Baroness Sharon Bowles appears to have run with LAPFF's IFRS engagement, submitting a long list of Parliamentary questions on audit company practice, at least one of which has yet to be answered. The Forum also responded to a Department of Transport consultation on the phasing out of vehicles powered by fossil fuels. A third submission went to the House of Commons Select Committee Inquiry on Decarbonisation and Green Finance.

2.6 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 F. 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 G 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 8, updating the Committee on all monthly employer contribution breaches over quarter.

5 Risk Register Update

5.1 The risk register is a live document and updated as required. Any changes are reported quarterly, and the register is taken annually to Committee to be approved.

5.2 There has been one addition to the risk register since the last Committee meeting. This is under Operational risk to cover the failure to implement new legislation correctly. There are currently a number of changes in legislation that are under consultation or in force, which could cause difficulties if not implemented correctly. The key legislative risk at the moment is the

implementation of the £95k cap, which is explained in more detail at section 7.

5.3 The new risk register entry is shown below with the suggested risk score:

Risk I10	Consequences	Controls	Risk Score*	
			L	I
Changes in legislation not implemented correctly.	Reputational risk, legal challenge, intervention from the Pensions Ombudsman.	Regular meetings with and reporting from WYPF LCC staff appropriately qualified and aware of legal requirements Pension Fund managed in line with statutory regulations Membership of professional networks. Pension Board oversight.	2	2

5.4 There is just one risk that remains red, as shown below. This was added in June 2016 as a result of the Brexit vote, and given the continuing uncertainty as to how this will play out, it is felt that the red status is still appropriate.

Risk I8	Consequences	Controls	Risk Score*	
			L	I
UK leaving the EU	Volatility of market Lower gilt yields leading to higher liabilities Inflation increasing liabilities Uncertainty of political direction re pooling	Increased monitoring of managers Review investment strategy Regular communications with Committee and Board	4	3

*As a reminder, L is Likelihood and I is Impact.

5.5 The Committee are asked to consider and approve the addition to the risk register.

6 Asset Pooling Update

Sub Funds

- 6.1 A further investment of 7.5% into the Global Equity Alpha sub-fund has been approved by this Committee, following the termination of the Invesco mandate. Discussions are underway with Border to Coast on this investment, and there may be an opportunity work with another Border to Coast Partner Fund who is looking to reduce their Global equity exposure, to purchase their units in a cost effective way. This is expected to take place in early 2021.
- 6.2 The investment with Border to Coast into the Multi Asset Credit (MAC) Fund is still expected to be completed in the first half of 2021. Ahead of this, the Fund invested in the MAC Fund's core manager, Pimco, in two tranches in July 2020. This will transfer to the Border to Coast Fund once that is launched.
- 6.3 Border to Coast has held a number of workshops with officers and advisors on the property offering, alternative investments and responsible investment.
- 6.4 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

- 6.5 The papers of the 24 November JC were circulated to all Pensions Committee members. Ahead of this meeting, a briefing call was held with all JC members on 18 November to discuss the Responsible Investment policies that would be coming to this JC for approval. Below are the agenda items for the meeting and the minutes will be circulated with the next JC agenda:
 - Joint Committee Meeting Arrangements
 - Joint Committee Budget
 - Responsible Investment Policies Review
 - Summary of Investment Performance and Market Returns
 - Performance Report
 - UK Listed Equity
 - Overseas Developed Equity
 - Emerging Markets Equity
 - UK Listed Equity Alpha
 - Global Equity Alpha Performance Review
 - Asset Transfer Planning 2021-24
 - ESG Passive Capability
 - Chief Executive Officer (CEO) Report
- 6.6 The next JC meeting will be held on 9 March 2021 and papers will be circulated to Committee members. Any questions or comments on the papers should be directed to Cllr Strengiel, who can raise them at the meeting.

Shareholder Matters

- 6.7 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.
- 6.8 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.
- 6.9 There have been no shareholder resolutions since the last report.

7. New legislation - £95k Cap Update

- 7.1 As you have been previously made aware in the Administration report, new legislation was being brought in to cap exit payments in the public sector to £95,000. These regulations, from the Treasury, came into force on 4 November 2020. For the LGPS, included in the cap is any payment that the employer would have to make in pension strain payments.
- 7.2 Whilst the £95k cap is an issue for public sector employer, there is a knock on impact for the Pension Fund in paying out unreduced pensions, as required within current LGPS Regulations.
- 7.3 A consultation from MHCLG was issued in September, with a closing date of 9 November, on reforming Local Government Exit Pay, including amendments to align them to the Treasury regulations. This has now been extended to 18 December for responses on the draft Regulations, due to the delay in Treasury publishing its guidance on the Exit Cap Regulations. This delay on the draft Regulations consultation means that the Local Government Pension Scheme Regulations will not be amended until early 2021, leaving the sector in the position of having pension scheme rules that appear at odds with the Exit Cap Regulations.
- 7.4 The key issue is that the current LGPS regulations do not allow for a reduced Pension to be paid to a member aged 55 or over taking early retirement due to redundancy, whilst the Treasury Regulations do not allow an employer to make exit payments in breach of the £95k cap. This would mean that should the Fund pay an unreduced pension to a member whose overall exit payment was in excess of £95k, then the Fund would not be able to recover the pension strain element from the employer, as it does now.

- 7.5 MHCLG Minister, Luke Hall, sent a letter on 28 October to LGPS administering authorities and local authority chief executives, in which the government set out its view that the Exit Pay Regulations effectively curtail the use of LGPS Regulation 30(7) to pay an immediate unreduced pension when the cap is breached. According to this view, a ‘capped’ member should only receive an immediate pension under LGPS Regulation 30(5) (with actuarial reductions applied), or a deferred pension, together with a ‘cash alternative’ payable by the employer under cap Regulation 8 of the Exit Cap Regulations.
- 7.6 The Fund has taken legal advice on what to do in the period between the Exit Cap Regulations coming into force on 4 November and the LGPS Regulations being amended early next year to expressly remove the entitlement to an unreduced pension under Regulation 30(7) which would result in a breach of the cap. In providing this advice, consideration was given to the Scheme Advisory Board opinion (based on the legal advice it had obtained).
- 7.7 The Fund's course of action across different scenarios, presenting the least risk to the administering authority, is set out below, and has been communicated to employers:

Scenario	Changes to how we process cases
Employees not covered by exit cap	No change needed, cases will be processed in the usual way.
Employees covered by exit cap but total exit payments including strain cost are under £95k cap	Detail on-going issue in correspondence to employer. Process estimates and retirement cases. Ask employers to confirm total exit payments on the retirement notification. The fund would only pay an unreduced pension if total exit payments to member were under £95k.
Employees covered by exit cap but total exit payments including strain cost are over £95k cap	Proceed on the basis that Regulation 30(7) of the LGPS Regulations is disapplied by Regulation 8 of the Exit Regulations and follow guidance from MHCLG and LGPS Advisory Board. Give member option to take a reduced pension or deferred benefits.

8 Budget and Business Plan Update

- 8.1 The Pension Fund budget and business plan were brought to the Committee at the March 2020 meeting. The paragraphs below update the Committee on the budget position to 30 September, and to highlight any areas on the key tasks from the business plan for 2020/21 where progress is behind expectations.

Pension Fund Budget Update

8.2 The budget for operating the Lincolnshire Pension Fund for 2020/21 plus actual costs incurred up to the end of September 2020 are set out in the table over the page, with additional narrative at paragraph 8.3.:

	Original Budget 2020/21 £'000	Q2 Actuals 2020/21 £'000	Variance Budget vs. Actuals Q2 £'000
<u>Administration Costs</u>			
- Charge from Shared Services Administrator	1,283	1,245	-38
- Other	1	1	0
<u>Investment Management Expenses</u>			
- Management Fees	9,172	-25	-9,197
- Performance Related Fees	0	0	0
- Other Fees	942	18	-924
<u>Oversight and Governance Costs</u>			
- Contracted Services	361	144	-217
- Recharge of Actuarial Services	-160	-40	120
- Recharge from Administering Authority (inc. Staffing Costs)	248	116	-132
- Border to Coast Governance Costs	0	234	234
- Other Costs	41	5	-36
	11,888	1,698	-10,190

8.3 Administration Costs: The annual administration charge from West Pension Fund has been received and paid. This was slightly lower than the original budget, due to a small reduction in the membership numbers, and a refund of £29.3k for the actual costs incurred for 2019/20 versus the original charge.

Investment Management Costs: The majority of the Fund's investments are made via pooled vehicles. The costs for these investments are mainly accounted for annually in March. For directly charged fee's billing from managers is in arrears, invoices for quarter one and two fees will be received in future months (the actuals position reflects a small variance between the Q4 2019/20 invoices and accruals from year-end).

Costs incurred on management fees reflect the size of the portfolio and investment returns. Costs in this area are very difficult to predict, particularly when markets and volatile.

Oversight and Governance Costs: Contracted services, the recharge of actuarial services and the recharge from the admin authority are spread throughout the financial year. It is expected that these budgets will be fully utilised by year end. Border to Coast governance costs were originally budgeted for under investment management expenses, management fees,

however, these costs should be classified under oversight and governance. There is likely to be an underspending in other costs due to reduced travel and attendance at conferences by the Committee, Board and Officers.

Pension Fund Business Plan Update

8.4 The key tasks set out in the Business Plan are set out below, with narrative to explain whether it is on track or otherwise:

Subject	20/21 Actions	Progress
Pensions Committee and Board meetings	Ensure all papers are prepared and presented in a clear and concise manner. Ensure that all relevant matters are reported to the Committee and /or Board.	On-going – all meetings held as expected.
Asset Pooling with Border to Coast	Continued partnership with Border to Coast to develop appropriate sub-funds for investment and ensuring appropriate oversight and governance of the company.	On-going – new investments made and further investments in the pipeline.
Administration Service (including employer data quality)	Continued partnership and oversight of West Yorkshire Pension Fund (WYPF) in the delivery of the administration service and to improve the reporting on data quality and management information.	On-going – good administration service provided despite Covid restrictions.
Annual Report and Accounting	A detailed project plan has been put in place, built on experience from previous years and updated for new requirements. On-going engagement with the external auditors to ensure all requirements can be met in a timely manner.	Delayed receipt of opinion due to issue with the Council's accounts. Pension Fund accounts ready by deadline with an expected unqualified opinion.
Responsible Investment (RI)	Continued information and training for the Committee and Board to understand RI. Working closely with external managers and Border to Coast to ensure that it is embedded across all investment decisions.	On-going – new investments agreed to further align the investment strategy with RI beliefs.

Actuarial Services Tender	Participate in the national framework refresh and call off the new framework once completed. Recommend an actuarial appointment to the Committee.	Completed – new Actuary appointed w.e.f 1 January 2021.
Work by the Scheme Advisory Board (SAB)	Participate in projects where possible and respond to any actions required – e.g. Good Governance Review, data quality.	Progress delayed due to Covid.
Employer Accounting	Work with employers, the Actuary and WYPF to ensure employers understand their choices, accurate and timely data is sent to the Actuary and accounting reports are received and understood by employers.	On-going – all reports issued as required to date, work beginning with new Actuary to understand their process.

8.5 As can be seen from the table above, year-to-date most key tasks are on track or completed, with the exception of some work with the Scheme Advisory Board and the year-end accounts sign off, where delays are beyond the control of the Pensions team.

9 Conference and Training Attendance

9.1 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.

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

Conclusion

10 The Fund has continued its recovery from the falls earlier in the year, and is 86% funded as at the end of September.

11 The Committee are requested to approve the addition to the risk register, as explained in section 5.

Consultation

a) 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	Distribution of Investments
Appendix B	Market returns (30 September 2020)
Appendix C	Invesco Voting Activity
Appendix D	Border to Coast Global Equity Alpha Voting Activity
Appendix E	Border to Coast UK Listed Equity Voting Activity
Appendix F	TPR Checklist Dashboard
Appendix G	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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