TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 9

PENSION FUND COMMITTEE REPORT

18 SEPTEMBER 2019

STRATEGIC DIRECTOR FINANCE, GOVERNANCE & SUPPORT – JAMES BROMILEY

Update on Current Issues

1. PURPOSE OF THE REPORT

1.1 To provide Members with an update on current issues affecting the Pension Fund locally or the Local Government Pension Scheme (LGPS) in general.

2. RECOMMENDATIONS

2.1 That Members note this report.

3. FINANCIAL IMPLICATIONS

3.1 There are no specific financial implications in respect of the information contained in this report.

4. ACTUARIAL VALUATION

4.1 Members will be aware that 2019 is a valuation year for the LGPS. The scheme actuary (AON) is carrying out a valuation of the assets and liabilities of the Fund as at 31 March 2019. The final report must be published by 31 March 2020 and the valuation outcome will set employer contribution rates for all the Fund's employers for the period from 1 April 2020 up until the day before the outcome of the next valuation applies (currently expected to be 31 March 2023).

4.2 AON agreed a timetable for provision of draft valuation results based on the date they received initial valuation data. The timetable is also dependent on when any data queries raised by the actuary are resolved. The timetable is set out overleaf:

Valuation timetable from AON's valuation terms of reference paper.

Stage	
Pre-valuation meeting to discuss the 2019 valuation process and the results of the demographic experience analysis	February 2019
Informal dialogue on financial assumptions and outlook	April - May 2019
Formal Assumptions advice	End of May 2019
Review Funding Strategy Statement	May - October 2019
Provision of data **(1):** • Membership Data • Cashflow data in the Valuation Information Model • Employer information in the Valuation Information Model	
Data validation and queries issued by AON	Data in + 1 week
Response to data queries provided by Admin Authority	Data in + 2 weeks
All data queries resolved	Data in + 2-3 weeks
Provision of final data to Government Actuary's Department (GAD) **(2)**	1 September 2019
Preliminary whole of Fund and Main Council results **(3)**	ll data queries resolved + 6 weeks
Standardised basis results to be provided to the Scheme Advisory Board **(4)**	30 September 2019
Final assumptions chosen and updated whole of Fund	October 2019
Individual employer results (to be provided in tranches)	tober - December 2019
Finalise employer contribution rates if changes required to individual employer funding strategies	December 2019 - February 2020
Draft Valuation Report	Early March 2020
Sign Report and Rates and Adjustments Certificate	March 2020

Notes

(1) The 2016 valuation membership data was provided on 31 August 2016, and the cashflow data on 6 October 2016.

(2) Assuming that the GAD timescales are the same as in 2016.

(3) These results will be based on an agreed probability of funding success. If additional results are required based on different probability of funding success then these would fall under note (5).

(4) Assuming that the SAB timescales are the same as in 2016.

4.3 XPS are expected to resolve data queries with the actuary in early September, meaning preliminary whole of Fund results and the result for the largest employers should be available in mid-October. Results for other Fund employers will be produced and distributed in batches over the period October to December.

4.4 Asset values as at 31 March 2019 are above the level forecast at the last valuation. However, assets are only one part of the valuation equation. The value of the Fund's liabilities is highly significant as well – the actuary is expected to take a more pessimistic view of future long-term investment returns than at the last valuation, and this will affect the way liabilities are valued as well as increasing the cost of providing benefits going forwards. As will the actuary's view of the risk return profile of the Fund's current and prospective future asset mix.

4.5 One particular challenge for the Teesside Pension Fund at this valuation is that if the outcome is an improvement in funding level, there may be a perception that this will result in reductions in contribution rates. However, as the Fund is already well funded, there is little scope for employers to see a benefit from a funding level improvement (through reduced deficit contributions for example). There is likely to be upward pressure on future service contribution rates for employers, as the long-term outlook for future investment returns has deteriorated.

4.6 One further challenge is changes that we expect to make at this valuation in relation to employer risk. Up to now, employer contribution rates within the Fund have been set using a valuation methodology that is broadly the same for all types of employer. This has the effect of treating all employers as if they have a strong covenant and, effectively, very little chance of becoming insolvent. The reality is more complex: some employers within the Fund do have weaker covenants and their pension liabilities may not be covered by guarantees from other employers. Many other LGPS funds take into account employer covenant when setting contribution rates, and our Fund is to some extent an outlier in not doing this. We are in discussion with the actuary to consider correcting this anomaly as part of the current valuation. This is likely to result in some employers (those seen as less secure, and so at more risk of becoming insolvent) being required to pay increased employer contributions. This should ultimately reduce the impact on other employers should there be an insolvency event. We are at an early stage in considering this approach and will look to ensure any increases in employer contribution rates that result are phased in over a number of years where possible.

5. LGPS COST MANAGEMENT PROCESS AND CHANGES EXPECTED BECAUSE OF THE MCCLOUD CASE

5.1 The LGPS, in common with the other public service pension schemes, has a mechanism for periodically checking whether the cost of providing the scheme falls within acceptable parameters. If the cost of the scheme is assessed as too high this results in potential reductions to future scheme benefits and/or increases on employee contributions. Conversely, if the cost is assessed as too low this can result in improvements to future benefits and/or reductions in employee contributions.

5.2 This is known as the cost management process and the outcome of the latest process revealed that the average overall cost of the scheme was 19% of pensionable pay, which is

0.5% of pensionable pay lower than the target cost for the LGPS of 19.5% of pensionable pay. Consequently the Scheme Advisory Board developed proposals to improve scheme benefits and reduce employee contributions to bring the cost of the scheme back up to the target level.

5.3 The proposals were not enacted and the cost management process was paused when the Government lost a high court case in December 2018 (the McCloud case) which had been brought by members of the Judges' pension scheme and the Firefighters' Pension Scheme, arguing that the protections put in place when changes were made to those schemes were age discriminatory, as they only protected older scheme members. This case has implications for all public service pension schemes, including the LGPS. The Government sought to appeal the case but the Supreme Court denied the Government leave to appeal in a decision on 27 June 2019. The Government subsequently issued a statement (enclosed as Appendix A) confirming that it will look at the issue of discriminatory treatment in the introduction of the new schemes across all public service pension schemes, including the LGPS.

5.4 It is likely to take many months before the employment tribunal comes to a conclusion in relation to the discrimination in the Judges' and Firefighters' pension schemes. The Government has said that alongside this process it will engage with employer and member representatives in the other public service pension schemes to determine how those schemes will be changed to remove the discrimination introduced by transitional protection.

5.5 In the meantime any cost management proposals remain on hold. Although it is very difficult to know what the eventual increase in pension liabilities will be as a result of this exercise, the Fund will work with the actuary to ensure an appropriate degree of prudence is built into the valuation outcome to take account of this.

6 SCHEME ADVISORY BOARD GOVERNANCE REPORT

6.1 The Scheme Advisory Board (SAB) commissioned consultants Hymans Robertson to survey LGPS stakeholders to examine the perceived effectiveness of current LGPS governance models and to consider alternatives or enhancements which could potentially strengthen LGPS governance in the future. Hymans Robertson published their Good Governance Report in July 2019 – the full report is at the following link: http://www.lgpsboard.org/images/PDF/GGreport.pdf the outcomes are summarised below.

6.2 Survey respondents were asked to comment on the following four potential models for LGPS governance:

- Model 1 – Improved practice: Introduce guidance or amendments to LGPS Regulations 2013 to enhance the existing arrangements by increasing the independence of the management of the fund and clarifying the standards expected in key areas.
- Model 2 – Greater ring fencing of the LGPS within existing structures: Clearer ring-fencing of pension fund management from the host authority, including budgets, resourcing and pay policies.

- Model 3 – Joint Committee (JC): Responsibility for all LGPS functions delegated to a JC comprising the administering authority and non-administering authorities in the fund. Inter- authority agreement (IAA) makes JC responsible for recommending budget, resourcing and pay policies.
- Model 4 - New local authority body – an alternative single purpose legal entity that would retain local democratic accountability and be subject to Local Government Act provisions.

The survey responses showed a first preference for Model 2 (greater ring fencing within existing structures) followed by support for Model 1 (improved practice).

6.3 The report concludes that

- Governance structure is not the only determinant of good governance.
- New bodies (such as a joint committee or a new local authority body) do not need to be established. Instead, the focus should be on greater specification of required governance outcomes from within the existing structures, and a process to hold funds to account for this.
- Respondents favour developing a set of standards that all funds are required to achieve, drawing on current best practice and not imposing disproportionate burden on administering authorities or disrupting current practices that deliver good outcomes already.
- Respondents emphasised that independent review is needed to ensure consistency in application of standards.

6.4 The SAB website has the following statement (dated 8 August 2019) setting out how the Good Governance Report will be built on and the project taken forward:

"The Scheme Advisory Board has invited the Hymans Robertson project team to assist the Secretariat in taking forward the next stage of the good governance project. Two working groups will be established, one to focus on defining good governance outcomes and the guidance needed to clearly set them out and the other to focus on options for the independent assessment of outcomes and mechanisms to improve the delivery of those outcomes. Both groups will comprise a wide range of scheme stakeholders to ensure a full range of views and options are considered. The aim is for an options report to be ready for the Board's consideration when it meets in November. Any proposals agreed by the Board would be subject to a full stakeholder consultation before being put to MHCLG. Details of both working groups will be published here shortly."

7. COMPETITION AND MARKETS AUTHORITY ORDER

7.1 On 10 June 2019 the Competition and Markets Authority (CMA) published the Investment Consultancy and Fiduciary Management Market Investigation Order 2019. The Order has potential implications both for LGPS investment pools and for LGPS Funds.

7.2 Investment pools will potentially be affected by the order if they are carrying out 'fiduciary management' for their underlying LGPS funds. 'Fiduciary management' typically involves a manager taking full responsibility for investment, including asset allocation decisions. As such, this is unlikely to be an issue for Border to Coast as the Funds retain asset allocation decisions. LGPS pools could also be affected by the new rules the Order puts in place around investment consultancy.

7.3 LGPS Funds are potentially affected as the order sets out rules about how pension schemes should obtain investment consultancy in future. This requires investment consultants to be appointed through a suitable competitive tendering process, and for them to be set objectives.

7.4 Further clarification is expected on the operation of the Order. From our Fund's perspective, both our investment advisers were appointed as part of a competitive tendering process and both have been set objectives as part of their appointment.

8. OTHER ISSUES

8.1 There are a number of other issues where a resolution is expected, including

- Statutory guidance on asset pooling: After carrying out a restricted consultation on changes to the guidance on asset pooling in the LGPS, the Ministry for Housing, Communities and Local Government (MHCLG) is expected to issue a further, more formal, consultation in due course.

- Probable changes to the valuation cycle, exit payments to employers and access to the LGPS in the further education sector: MHCLG has recently consulted on proposals to move the LGPS to a four year valuation cycle, change how any payment due to an exiting employer should be calculated and no longer require further education colleges to put all new non-teaching staff in the LGPS. A conclusion on these issues is still outstanding – MHCLG received around 280 responses to its consultation and expects to publish their response in the autumn.

- Cap on exit payments over £95,000: Government consultation ended earlier this year, awaiting regulations to enact the proposals (originates from pledge made in 2015 election manifesto). Around 600 responses were received to the consultation – an update is likely to be published in the autumn with the cap probably being introduced no sooner than April 2020.

9. NEXT STEPS

9.1 Further updates will be provided periodically.

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