TEESSIDE PENSION BOARD

A meeting of the Teesside Pension Board was held on Monday 27 July 2020.

PRESENT: C Monson, G Whitehouse (Vice-Chair), J Cook, Councillor C Hobson and L Littlewood

OFFICERS: S Lightwing, N Orton, D Johnson and C Lunn

20/11 APOLOGIES FOR ABSENCE

No apologies for absence were submitted.

20/12 DECLARATIONS OF INTEREST

Name of Member	Type of Interest	Item/Nature of Interest
J Cook	Non pecuniary	Member of Teesside Pension Fund
Councillor C Hobson	Non pecuniary	Member of Teesside Pension Fund
L Littlewood	Non pecuniary	Member of Teesside Pension Fund
C Monson	Non pecuniary	Member of Teesside Pension Fund
G Whitehouse	Non pecuniary	Member of Teesside Pension Fund

20/13 MINUTES - TEESSIDE PENSION BOARD - 10 FEBRUARY 2020

The minutes of the meeting of the Teesside Pension Board held on 10 February 2020 were taken as read and approved as a correct record.

The Head of Pensions Governance and Investment provided an update on the McCloud Case. The Government had accepted the findings and would change the rules in the Local Government Pension Scheme to extend the underpin. A report would be provided to the next Board meeting detailing the changes.

20/14 SUSPENSION OF COUNCIL PROCEDURE RULE NO 5 - ORDER OF BUSINESS

ORDERED that, in accordance with Council Procedure Rule No 5, the Board agreed to vary the order of business. The remaining agenda items would be considered in the following order: items 4, 5, 6, 7, 9, 8, 10, 11 and 12.

20/15 MINUTES - TEESSIDE PENSION FUND COMMITTEE

Copies of the minutes of the Teesside Pension Fund Committee meetings held on 22 January, 11 March and 17 June 2020 were submitted for information.

20/16 TEESSIDE PENSION FUND COMMITTEE - 22 JULY 2020

The Head of Pensions Governance and Investments provided a verbal update on agenda items considered at a meeting of the Teesside Pension Fund Committee held on 22 July 2020. The main point highlighted was the financial impact on the Fund of the Covid-19 pandemic. This one event had dominated the year financially and the outcome for the Fund.

It was queried whether additional costs incurred by the External Auditor during the audit of the Accounts resulting in extra work being required due to Covid-19 pandemic could be reclaimed from the Government. The Head of Pensions Governance and Investments stated that this could be investigated but added that he thought this was unlikely to be the case.

NOTED

20/17 **TEESSIDE PENSION BOARD ANNUAL REPORT 2019/2020**

A copy of the Teesside Pension Board Annual Report 2019-2020 had been circulated with the agenda for the meeting. It was highlighted that the Board's Work Plan was now included the Annual Report.

AGREED that the Teesside Pension Board Annual Report 2019/2020 was approved.

20/18 **DRAFT ANNUAL PENSION FUND REPORT AND ACCOUNTS 2019/2020**

A report of the Director of Finance was present to provide Members of the Teesside Pension Board with the 2019/2020 draft Annual Report and Accounts for the Teesside Pension Fund.

The terms of reference for the Teesside Pension Fund Committee required the Annual Report and Accounts to be considered by Members. The Draft Report and Accounts for the year ended 31 March 2020, which were presented to the Pension Fund Committee meeting on 22 July 2020, were attached to the submitted report.

The performance highlighted the volatility during 2019/2020, when markets increased and then dropped off significantly, and it was noted that the Accounts were produced about one week after the markets were at the lowest point. The Fund's value fell to approximately £3.74 billion - a decrease over the year of approximately £350 million. However, provisional information for 30 June 2020 indicated that the value of the Fund had gone back up to £4 billion.

In this financial year the Fund received just under £4.0 million from early retirement recharges, down on last year's figure of £4.1 million, a 2% decrease on last year.

The global pandemic issues slightly overshadowed the very positive outcome of the latest actuarial valuation of the Fund. As at 31 March 2019, the funding level of the scheme had improved from 100% at the previous valuation, to 115%. This was third report in a row where the scheme had been declared fully funded. As a result, there had been a reduction in Employer contribution rates; which was a real benefit to those Employers. The next valuation would be carried out as at 31 March 2022 and contribution rates for that would be changed from April 2023.

Another point to note was that membership of the Fund continued to increase and the overall scheme membership was approximately 71.5K. This indicated that around one in seven of the population of the Tees Valley were scheme members.

A query was raised in relation to the governance and oversight cost stated in the report at page 13 and the Head of Pension Governance undertook to check and correct the figure provided.

In relation to the Asset Allocation Strategy, it was confirmed that work was ongoing with the Fund's Advisers to achieve the agreed targets. It was suggested that interim targets could be considered, for example, to reduce equities by a set amount, perhaps 5%, per year, towards the target allocation.

A final question was asked in relation to the performance reporting which appeared to show a negative cash return. The Head of Pensions Governance and Investment agreed to investigate and circulate a response to the Board members.

AGREED that the 2019/2020 draft Annual Report and Accounts for the Teesside Pension Fund were received and noted.

20/19 **IMPACT OF THE CORONAVIRUS PANDEMIC ON THE PENSION FUND**

A report was presented to provide Members of the Teesside Pension Board with an initial assessment of the impact of the coronavirus pandemic on the Pension Fund.

The Fund was primarily invested in Equities. Although the strategic asset allocation to equities was set at 50%, this allocation was set relatively recently and the portfolio was only gradually being moved from its current allocation which was significantly higher - typically around 75% equities. The coronavirus pandemic led to a quick and dramatic fall in global stock markets, and this was reflected in the Fund valuation as at 31 March 2020. The Fund's equity holding reduced in value by around £600 million in the three months to 31 March 2020.

Stock markets to some extent recovered after hitting lows towards the end of March, with US markets in particular improving, although the UK stock market has not bounced back as quickly. Some of the Fund's other assets had been affected to a lesser degree due to their illiquid nature. Although the Fund's private equity and infrastructure could be adversely affected it would take some time for a correction to take effect.

Another point worth noting in the private equity and infrastructure asset classes was that it was already taking a long time to invest. The Fund had committed £200 million to Border to Coast to invest this year and as at the end of the year, less than £20 million had been invested. This could be advantageous to the Fund as it could allow for investments in any other bargain opportunities that were available.

The value of the Fund's UK Direct Property Portfolio was likely to be affected by lockdowns and by the pace at which normality returned. Retail assets in particular were affected. The Fund's Property Advisors had been approached to provide rent holidays on some properties. It was acknowledged that it was generally a better to retain a tenant than try to replace them at such a difficult time.

The Fund was not getting good returns on cash, which was linked to the Bank of England base rate which dropped even further at the start of the reaction to the pandemic and was now 0.1%. The income from cash, which was about £4 million last year in interest, would diminish as well, due to the low interest rates. However, the Fund was a long term investor and over time asset values tended to recover and the drop in value would not necessarily be detrimental to the long term funding. The biggest risk was that global economic growth would be flat or even negative going forward. There was also a potential risk of inflation.

The Pension Fund had for a number of years been cash negative. This meant the amount paid out in pension benefits exceeded the amount collected in employer and employee contributions. This was quite normal for a Local Government Pension Scheme fund, particularly one which was relatively well funded and did not require many of its employers to make additional, deficit correction contributions. Provided the additional cash requirement could be met in a planned way, which did not require the Fund to sell risk assets at an in appropriate time, a cash negative position could be well managed.

The Pension Fund had significant cash holdings and, even taking into account the future commitments it had made to invest in infrastructure and private equity, it would have sufficient cash to ensure all pension payments could be made over at least the next couple of years without having to sell any assets. Officers would work with advisors to develop a long-term approach to cash flow management within the Fund.

One potential issue had been the Scheme Employers and concerns that they might not be able to pay their contributions. All Scheme Employers had been contacted and to date, all contributions had been paid on time.

Officers had kept in regular contact with XPS throughout the period of the pandemic and subsequent lockdown. XPS was able to move quickly to a position where the team could operate effectively working from home and continue to administer the Fund. The team continued to carry out all of its administration functions including processing new entrants, leavers and retirements, as well as ensuring pensions continued to be paid. XPS were encouraging scheme members to contact them via email rather than post and some of the changes that they were looking to introduce anyway had been accelerated.

When the lockdown began in March, the Pensions Team already had the capability to work from home and monitoring of investments, governance support and oversight of the outsourced administration contract continued. The Head of Pensions Governance and Investment also confirmed that the team had kept in regular contact with all investment managers throughout the pandemic. Middlesbrough Council had already been moving towards more employees being able to work agile. A recent survey of employees working from home during the pandemic indicated that only 18% of staff wanted to get back to working in the office.

One area where the Fund's governance was affected was in the cancellation of the Board meeting scheduled for 20 April 2020. Unfortunately, the Council was not in a position to ensure the meeting could be held effectively remotely and the decision was taken to cancel that meeting. However it was noted that under the prevailing legislation, local pension boards were required to meet at least twice a year and this requirement would still be met. The Teesside Pension Committee had met remotely on 17 June and 22 July 2020 and meetings were now more accessible to members of the public as they were streamed live via the Youtube platform.

The submitted report covered the medium and long-term impacts, the economic impact on the Fund and the drop in the asset values. One outcome was that the next valuation was likely to be less favourable than the current valuation. The Fund Actuary had provided some wording to share with Employers to warn them that they could see an increase in contribution rate from the next valuation. Admission Body Employers could see an increase even sooner as this was permissible if felt necessary.

UK unemployment had increased significantly over the last few months, as had Government debt. Ultimately this could mean reduced funding for local government and fewer active members contributing to the Fund. This could serve to further accelerate the rate at which the Fund matured, and increase the shortfall between benefits and contributions. This underlined the importance of planning for cash flow provisions within the Fund going forwards.

AGREED that the report was received and noted.

20/20 **AUDIT PLANNING REPORT ADDENDUM**

The Teesside Pension Fund Audit Planning Report for the year ended 31 March 2020 had previously been considered by the Teesside Pension Fund Committee at the March meeting. That Planning Report was prepared prior to the impact of the Covid-19 pandemic, and this Addendum Report had been prepared to provide an update on how Covid-19 had impacted the External Auditors' risk assessment and the additional response which would be built into the audit as a result.

The External Auditor highlighted updates to two significant risks that had previously been identified: the valuation of unquoted pooled investment vehicles and the valuation of directly held property. The valuation of the Fund's investments in unquoted pooled investment vehicles had been identified as a significant risk, as even a small movement in the assumptions underpinning investment manager valuations could have a material impact on the financial statements. Unquoted assets were either Level 2 or Level 3 on the Fair Value Hierarchy, which meant that quoted market prices were not available and the valuation relied on the use of inputs derived from observable market data (Level 2) or were not based on observable market data (Level 3). The approach usually taken to value these assets had changed due to the market volatility brought about by Covid-19 in the final quarter of 2019/2020. The Auditor needed to consider the revised valuation approach taken by the Fund and its fund managers in order to gain assurance that the impact of Covid-19 on investment values had been properly accounted for in the financial statements. The Auditor would also look at private equity investments across other LGPS clients and check that movements were broadly in line.

In relation to directly held property - this was a significant risk because property was inherently judgemental in its valuation technique. The additional complication from Covid-19 was that the professional valuer that the Pension Fund used to prepare the valuation on properties at year end had provided that valuation on the basis of 'material value uncertainty'. This was something seen from all property valuers across the year end and was not specific to the Pension Fund. It did not mean that valuations could not be used in the Accounts or that they were not appropriate - there was just a little bit more uncertainty and more estimation in those values than usual. EY Real Estate had been engaged to look at a sample of the valuations to ensure that the additional uncertainty risks were adequately addressed.

The Auditor also highlighted other potential impacts of Covid-19 including: going concern and post balance sheet event disclosures and changes introduced to EY's review and consultation procedures.

Materiality levels for the audit were originally set at 1% of net assets. Given the decrease in Fund asset values, the Auditor had considered whether 1% was still an appropriate threshold and was satisfied that it was. Materiality had therefore decreased from £40.8 million stated in the planning report and was now set at £37.4 million. Performance materiality had been set at £28.0 million which represented 75% of materiality and the threshold for audit differences was £1.9 million.

In response to a query regarding the extra cost to the Fund incurred by the additional work on the increased risks, the External Auditor responded that it would be misleading to provide a figure at this stage since it would depend on what extra procedures were necessary.

It was highlighted that pooled investment vehicles were the majority of the Fund's asset base. Although there were some very high values, there were not many of them, so the Auditor would focus testing on individual funds.

AGREED that the report was received and noted.

20/21 **UPDATE ON WORK PLAN ITEMS**

A report was presented with information on items scheduled in the work plan for consideration at the current meeting, and at the cancelled meeting which was due to be held in April 2020.

At its meeting on 10 February 2020 the Board agreed a work plan for the coming months and years which set out areas for the Board to discuss or consider at subsequent meetings. These were typically areas that the Pensions Regulator and/or the Scheme Advisory Board had identified as important for Local Pension Boards to consider.

Included within the work plan to be covered in the April meeting and at today's meeting were the Annual Board Report and the Draft Report and Accounts and these were covered as separate agenda items.

The Head of Pensions Governance gave a comprehensive presentation on the other areas set out in the work plan which were as follows:

- Reporting Breaches and Reporting Duties.
- Maintaining Contributions.
- Pension Board Conflict of Interests.
- Review of the Outcome of the Actuarial Reporting and Valuations.

A copy of the Teesside Pension Board's Conflicts of Interest Policy was attached at Appendix A to the submitted report.

AGREED that the information provided was received and noted.

20/22 **XPS ADMINISTRATION REPORT**

A report was presented to provide an overview of administration services provided to the Teesside Pension Fund by XPS Administration, Middlesbrough.

XPS had planned for a potential lockdown due to the Covid-19 pandemic and staff had been able to work from home since March. The office had been opening twice a week to deal with post and scanning. The service had been maintained and all Service Level Agreements (SLAs) detailed in the report were maintained at 100%. Since the end of March there had been only one case for a new starter that had not met the required timescale, however, the SLAs had still been met at 98.5% in April, and maintained at 100% in May and June.

Consideration was now being given to bringing staff back into the office to work, in line with Government policy. Over 80% of XPS staff had indicated they were happy to work at home for part of their working week. There was no pressure on anyone to work in the office at the current time.

In response to queries, it was confirmed that work was ongoing as to whether reports could be produced internally on Conditional Data, (rather than using an external firm), and also the move to monthly contributions postings. Both projects had been delayed due to the Covid-19 pandemic. It was anticipated that the majority of Annual Benefits Statements would be issued at the end of August and details of the exercise would be reported back to the Board.

On behalf of the Board, the Chair thanked all the staff for their efforts to maintain services since the lockdown due to Covid-19.

AGREED that the information provided was received and noted.