Nottinghamshire County Council

Report to Pensions Sub-Committee

Agenda Item:

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

LGPS TRUSTEES CONFERENCE 2016

Purpose of the Report

1. To report on the 13th Annual LGPS Trustees Conference.

Information and Advice

2. The 13th Annual LGPS Trustees Conference, organised by the Local Government Pensions Committee (LGPC), was held on 23 to 24 June 2016 in Manchester. In accordance with prior approval and as part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills, the conference was attended by Terry Needham Pensioners representative, and Jonathan Clewes (Pensions Team Manager.

3. **Keynote Address**
The Keynote Address was presented by Angela Rayner MP Shadow Pension Minister, who covered a number of main topics including the transparency of costs on pension funds relating to investment costs. She also focused on increasing pension's awareness and the need to be more flexible relating to the state pension age.

4. **Pooling – without making a splash**
David Walker, Head of LGPS Investments, Hymans Robertson, acknowledged that this is a busy period for funds with the concept of Asset Pooling. He explained about the 8 provisional pools, and the need to make the best use of pools by using the purchasing power to reduce costs, with other benefits including better governance, along with sharing and building knowledge and expertise as well as greater engagement across funds and pools.

   David went onto describe the main objective for the LGPS is to generate long term real returns above inflation along with trying to address issues relating to management fees being too expensive, along with the balance of risk not being right, and the desire for development versus operational risk.

5. **Drive towards cost Transparency in UK Pension Funds**

   Dr Christopher Sier Professor, Newcastle University Business School. This was a very interesting presentation relating to the costs of investment management and the need for transparency towards costs within UK Pension Funds. It was explained that there is a lot going on and especially the Financial Consumers Panel driving towards cost transparency in

UK Pension funds. He explained that the cost of pension funds in the UK and globally, are not well understood, either by the consumer or by the Pension Fund.

Please see the link to the document "The Drive towards Cost Transparency in UK Pension Funds.

https://www.fs-cp.org.uk/sites/default/files/finalthe_drive_towards_cost_transparency_in_uk_pension_funds_2015_2016.pdf

6. **Pension Tax – Implications for the LGPS**

Kirsty Bartlett, Squire Patton Boggs outlined the impact of recent changes in tax limits and this relates to the maximum amount of pension savings in a registered pension scheme without incurring an additional tax charge (includes savings across all schemes of which member. The LTA has reduced from £1.5m to £1m from 6 April 2016 and the LTA will be indexed from April 2018 to rise annually in line with the CPI

Kirsty went on to explain about the Annual Allowance and the reduction to £40K for Tax year 2015/16

The practical points for funds is that the Fund must notify members whose LGPS benefits have exceeded the Annual Allowance which was acknowledged that identification of all potentially affected members could be a problem in practice. The reduction in the Annual Allowance leads to more individuals being affected by tax charges. This allows members to cover the charge and make a corresponding reduction in benefits. It applies only in certain circumstances and can be quite complicated.

There was an update on the 2016 Budget where there were few changes which impact the LGPS directly, talked about the Lifetime ISA, the increase in employer-funded independent financial advice, the introduction of a new guidance body to replace Money Advice Service, the Pensions Advice Service and Pensions Wise. Then finally the government are ensuring that the pensions industry designs, funds and launches a pension's dashboard by 2019.

Still to come are the restrictions on salary sacrifice schemes, pension ISA's, flat rate tax relief, and clawback of past tax relief.

7. **Around the Corner – IN or OUT (presented on 23 June)**

This was presented by John Exley KPMG, the presentation looked at the potential implication of staying in the EU or the future if there was a vote out. On the day the a remain vote was perceived to return to status quo but with possible political fall out in the Conservative Party along with weakened negotiating power of the UK in Europe. It was presented that there would be more uncertainty around what the future would look like on a leave vote. The general consensus was that there would be significant short term disruption and temporary (or otherwise) impact on growth and investment. It was stated that the long term picture would be unclear, with the possibility that the change would not mean any difference from the current position. There was also the position that Europe could actually operate better as a EURO zone, or it could fracture. There was also the possibility that Scottish independence could resurface. Given the points raised it was very unclear what the impact on the markets was going to be.

John went onto explain what the impact would be on the following:

- Currency
- Rates
- Inflation
- Equities
- Credit
- UK property

The conclusion was that a remain vote would mean a return to the status quo, but John hedged his bet and stated possibly not. It was also stated that a leave vote would create significant uncertainty over the next few years. The general consensus at the time on some key markets responding to a leave vote was:

- The currency would weaken further on exit
- Short term inflation impact
- Impact on UK property not certain but unlikely to be positive

It was also reported that there was less consensus on other markets on a leave vote

- UK interest rates were considered a real puzzle
- UK equities more affected by global issues – including wider impact on Brexit
- Credit markets will have winners and losers.

The final comment was “possible interesting times ……. From about 5am on Friday 24 June.

8. **Outlook for 2016 Valuation**

Graham Muir, Barnett Waddingham gave a view on the outlook for the 2016 valuation focusing on how valuations are done and the key issues. The valuation is undertaken through three steps:

Step 1 Projection of all possible benefit payments for each member
Step 2 Attach probabilities to each possible payment to get “expected” payments
Step 3 Discount “expected” payments to obtain the “value”

In undertaking the valuation there are a number of assumptions these being:

- Cash flows, including inflation and mortality and other statistical assumptions
- They identify expected payments, the discount rate
- Funding valuation – expected future investment returns

Graham then took us through the change in Asset values from March 13 to March 16 looking at projected assets, Uk equities, and Uk gilts.

Therefore the calculation includes

- Value of assets
- Value of Liabilities
- Future Inflation
- Future mortality
- Future investment returns/ discount rate.

As part of the process there is a need to compare funds and the reasons for this are as follows:

- Concerns over scheme data and comparisons
- The purpose of comparing is to spot the “good funds”/ “bad funds” and identify are employers paying “enough”
- Funds are different though with different investment strategies/ mortality/ risk appetites/ time horizons/ funding plans

The final part of the presentation went into mortality screening using CMI_2015 model which predicts lower life expectancies and therefore expect lower liability valuation.

9. **The Government Actuary**

Martin Clarke presented a view on the LGPS comprising of 91 separate funds with their own valuation processes and corresponding contribution outcomes. He focused on the in aggregate the LGPS had liabilities of £204bn compared with assets of £181bn in 2013. He went on to describe a review which is designed to provide an overview of the 91 separate valuations by four actuarial firms, and the appropriateness of the employer contributions.

10. **UNISON’s View 2016**

Glyn Jenkins Head of pension’s head of pensions Unison presented Unison’s view 2016 on the LGPS England and Wales he made a number of points these being that the LGPS remains affordable and any problems relate to the past. He also stated what Unison believe to be the main challenges these being:

- The LGPS must remain open to new members and protect those that are involved in outsourcing.
- The assumptions for the next valuation
- The increase in NI in April
- Possible change to tax relief
- Pension’s freedom.

In terms of what needs to be done Unison put forward a number of points, the main point being tackling deficits?

- They hope that new fund boards will be given a chance to work and to improve the transparency and operation of fund management.

- Unison believe that something must be done about charges especially controlling and disclosing transaction charges.
- Let's look at all assumptions – swap best estimates for prudence. Let's not forget it is statutory scheme with a very strong employer covenant.

11. **Markets in Financial Instruments Directive (MiFID II) + Institutions for Occupational Retirement Provisions (IORPs)**

In broad terms, MiFID II is concerned with the framework of trading venues/structures in which financial instruments are traded.

The IORP Directive is a modern, comprehensive prudential framework designed to secure the retirement income of European citizens. It lays down that pension funds should:

- Have sufficient assets to cover pension commitments
- Possess professionally qualified governing bodies, sound administrative procedures and adequate internal control mechanisms
- Be transparent towards plan members by clearly communicating the target level of benefits, risk exposure and investment management costs.

Given the vote to leave the implications were identified as:

- HMG would need to trigger Article 50 – which has been part of some of the recent discussions on the leave vote.
- Then 2 years to decide UK-EU relationship
- There is a likelihood of continued compliance with much of IORPII and MIFIDII

Given the vote a number of issues and actions were identified, these being:

- Potential impact on the scheme portfolio – potential fire sale
- Monitor latest developments. The LGA in discussion with DCLG/ HMT re pooling and mitigating the election process.
- Discuss with the scheme investment managers what their plans are.

12. **Investment Outlook: Time to sink or swim**

The final presentation focused on what has happened in the investment markets over the last 12 months. It was clear that it had been a year of rollercoaster ride for the markets, with China's economy slowing down all be it there still being growth in their economy but not as much as in recent years, as their economy moves from an investment led to a consumption led economy. The price of oil has had an impact with the supply being the key due to sale oil having an impact and reducing the cost. Interest rates have also been low with no increase in the foreseeable future. Other impacts on the markets have been the possible impact of Donald Trump and him running for President, with his rhetoric on his policies which may have an impact on global trade.

The increase in robotic technology is also making its mark, along with emerging markets being in the news for not good reasons especially South America, the Volkswagen emissions scandal and the BHS pension's deficit have also had an impact, along with the vote to leave.

The presentation went onto look at where are the opportunities for investment, performance in the equity market over the past 5 years culminating in 2015 with Japan, USA and Europe the best performing with the Uk in 4th place.

It was identified that property opportunities are changing with a move away from high street shopping to large online warehousing as the growth area. High yield bonds were also identified these being Energy, materials, Hotels & leisure, capital Goods and retail. However it is important to be selective.

In respect of defensive assets it was stated that funds should not rely on the traditional defensive assets like Government bonds, but should be looking for "lifeguard assets" to help out in times of trouble, and if all else fails Cash is King.

The final message was be careful when looking at infrastructure, hedge against the unknown.

In terms of all the above the important considerations when pooling assets is look at the breadth of the investments, along with flexibility in being able to move the portfolio, but be selective, be careful with emerging markets. While obvious it is necessary to limit unforced errors and this can be done with an extra level of scrutiny.

Statutory and Policy Implications

13. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That it be noted that attendance at key conferences is part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills.
2) That the report be noted

Report author:
Jonathan Clewes
Pensions Manager

For any enquiries about this report please contact: Jonathan Clewes

Constitutional Comments

14. Because this report is for noting only, no Constitutional Comments are required.

Financial Comments

15. There are no financial implications arising from this report. (SC

Background Papers and Published Documents
Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

Copy of The conference documentation “In at the deep end”