

Croydon Council

REPORT TO:	Local Pension Board 17 October 2019
SUBJECT:	The Local Government Pension Scheme Advisory Board- Annual Report 2018
LEAD OFFICER:	Nigel Cook Head of Pensions and Treasury

1. RECOMMENDATION

- 1.1 To note this report.

2. EXECUTIVE SUMMARY

- 2.1 This report summarises the findings of the Local Government Pension Scheme Advisory Board Annual Report for 2018. The Report covers governance, funding, membership, investment and the financial, auditor and adviser statements. The full report can be accessed at <http://www.lgpsboard.org/index.php/schemedata/scheme-annual-report>.

3 DETAIL

- 3.1 The Advisory Board's Report is presented as follows:

- Foreword / Highlights (Paragraph 3.2);
- Governance (Paragraph 3.3);
- Funding (Paragraph 3.4);
- Membership (Paragraph 3.5);
- Investment – Asset Stewardship (Paragraph 3.6), Investment Allocation (Paragraph 3.7) and Investment Performance (Paragraph 3.8);
- Financial Statements 2018 (Paragraph 3.9);
- Auditor Statements (Paragraph 3.10);
- Advisor Statements (Paragraph 3.11).

3.2 Foreword / Highlights

- 3.2.1 In his Foreword, the Chair of the Board describes the Local Government Pension Scheme (Scheme) as one of the largest defined benefits schemes in the world and the largest in England and Wales. It has 14,800 employers, £5.8m members and assets of £275bn. The Report aggregates information supplied in the 89 fund annual reports as at 31 March 2018. The Chair identifies highlights as follows:

- Total membership grew by 3.4% from £5.6m in 2017 to £5.8m in 2018;
- Total assets increased by 5% to £275bn invested in pooled investment vehicles (54%), public equities (29%), bonds (7%), direct property (3%) and other asset classes (7%);
- Net return on investments of 4.0% for the year 2017/18 reflected market conditions;
- Contributions exceeded benefits payments by £1,845m; total net additions from dealings with members totalled £1,619m;
- Over £1.7m pensioners were paid over the year.

3.2.2 As at 31 March 2016 total Scheme liabilities were estimated at £254bn indicating an overall funding level of 85%. The next valuation of the funds in the Scheme will be as at 31 March 2019.

3.3 Governance

3.3.1 At the national level the Scheme is governed by the Department of Communities and Local Government (DCLG) [renamed as Ministry of Housing, Communities and Local Government (MHCLG) in January 2018] and the Scheme Advisory Board. The Scheme has to take account of guidance issued by the Pensions Regulator and Pensions Ombudsman determinations.

3.3.2 MHCLG issues statutory guidance and each administering authority is required to publish a governance compliance statement and explain any non-compliance. Each administering authority is subject to an annual external audit and has to publish an audited financial statement and annual report.

3.3.3 The role of the Scheme Advisory Board is to help and support MHCLG and administering authorities fulfil their statutory duties and obligations. Training has been delivered to the Board on an ongoing basis at its meetings and through its professional advisers and attendance at Scheme conferences and other events.

3.3.4 At the local level, each Scheme fund is administered by its administering authority. From 1st April 2015, under the provisions of section 5 of the Public Service Pensions Act 2013 and regulation 106 of the Scheme Regulations 2013 (as amended) each administering authority must establish a Local Pension Board.

3.3.5 The investment and management of Scheme assets, the collection of employer and employee contributions and payment of pension benefits is the responsibility of Scheme administering authorities.

3.3.6 To assist in the establishment of local pension boards, the [then] Shadow Scheme Advisory Board developed [guidance](#) on the creation and operation of Local Pension Boards for Administering Authorities.

3.4 Funding

- 3.4.1 In line with the Scheme regulations, the funds' actuarial positions are reviewed every three years. The triennial valuation results shown in the 2018 Annual Report and Accounts were based on membership data and asset values as at 31 March 2016.
- 3.4.2 As at 31 March 2016, the total asset value of the Scheme was £216bn, compared with £181bn as at 31 March 2013. The liabilities totalled 254bn in aggregate producing an overall funding level of around 85%.
- 3.4.3 By way of comparison, as at 31 March 2016, the funding level of the 5,945 direct benefit occupational pension schemes within the Pension Protection Fund Index was 81.0% (on an insurance buyout basis, which is different from the Scheme actuarial valuation methodology). As at 31 March 2016 the University Superannuation Scheme funding level was 83%.
- 3.4.4 The Board has produced a detailed report on the valuation and provided some wider context as to a) how employer contribution rates are calculated during valuations, and b) how individual fund valuations relate to the Board cost management process.
- 3.4.5 They have also provided the following aggregated information from the annual report and audited accounts of the Scheme funds showing the development of the Scheme. Importantly, this shows that active membership increased and contribution payments continued to exceed benefit payments, which is consistent with the Scheme remaining open to new entrants.

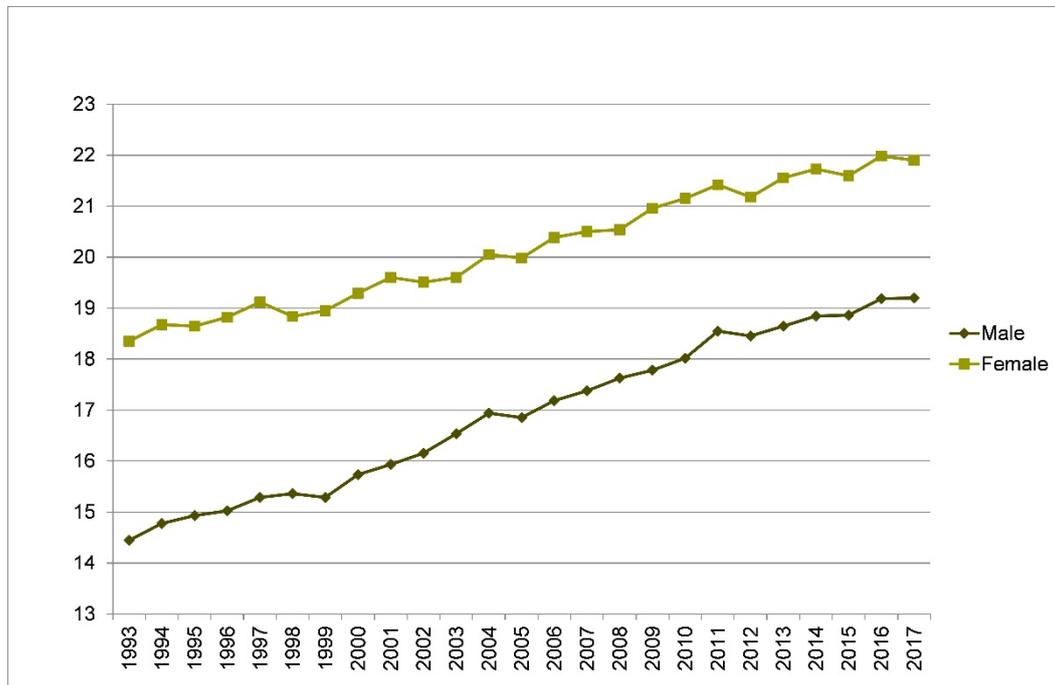
Table 1: Development of the Scheme

	2018	2017	2016	2015	2014	2013
Number of actives (000)	2,010	1,964	1,899	1,905	1,819	1,728
Number of deferred (000)	2,159	2,078	1,859	1,834	1,723	1,621
Number of pensioners (000)	1,691	1,642	1,530	1,512	1,459	1,408
Total value of assets (£bn)	275	263	217	217	192	180
Net return on Investment (%)	4.4	19.4	0.1	12.1	5.9	12.5
Total contributions paid (£bn)	11.8	9.7	9.3	9.6	8.7	8.3
Total benefits paid (£bn)	9.9	9.7	9.4	9.0	8.6	8.2
Inflation (CPI) (change over previous 12 months to September) (%)	3.0	1.0	0.0	1.2	2.7	2.2

- 3.4.6 Hymans Robertson and Club Vita have developed a Scheme Life Expectancy Index to support the work of the Board. This Index will help support the communication of changing life expectancy in the Scheme to its members. The Index will also provide the Board with longevity related information, including early warning of upwards cost pressures to support its role in the cost management process.
- 3.4.7 The chart below demonstrates the annual progression of the Scheme Life Expectancy Index between 1993 and 2017 for male and female England and

Wales Scheme pensioners. It measures the number of years members are expected to live after reaching the age of 65.

Chart 1: Years in retirement from age 65 (1993 - 2017)



3.5 Membership

3.5.1 At 31 March 2018, the total membership of the Scheme was 5.8m, compared with 5.6m at 31 March 2017. The greatest increase in absolute and relative terms was in deferred membership, which increased by 4.1% over the year. This was due in part to the reporting of undecided leavers previously not included in deferred totals.

3.5.2 Increases in membership of all types over the last six years are shown in the table below.

Table 2: Categories of Membership

(000s)	Actives	Deferreds	Pensioners	Total
2012	1,705	1,529	1,366	4,600
2013	1,728	1,621	1,408	4,758
2014	1,819	1,723	1,459	5,001
2015	1,870	1,798	1,487	5,156
2016	1,899	1,859	1,530	5,289
2017	1,964	2,078	1,642	5,684
2018	2,010	2,159	1,691	5,861
Increase (decrease) 2013	1.4%	5.7%	3.0%	3.3%

Increase (decrease) 2014	5.0%	5.9%	3.5%	4.9%
Increase (decrease) 2015	2.7%	3.7%	1.9%	2.8%
Increase (decrease) 2016	1.5%	3.3%	2.9%	2.5%
Increase (decrease) 2017	3.3%	10.5%	6.8%	6.9%
Increase (decrease) 2018	2.3%	4.1%	3.7%	3.4%

3.5.2 The total number of employers listed in Fund annual reports and accounts for 2017/18 was 14,785, compared with 14,019 for 2016/17. The table below shows the average number of employers per fund by type of administering authority.

Table 3: Scheme Employers

Fund administering authority type	Count of funds	Average number of employers per fund
Metropolitan Districts	7	400
County Councils	38	261
Other	4	37
Wales	8	59
London Boroughs	32	46

3.6 Asset stewardship

3.6.1 Collectively the £275bn Scheme funds make up one of the largest 10 global sources of capital and can influence behavioural changes that lead to better stewardship by the global asset management community and the entities and places in which they invest.

3.6.2 The UK Stewardship Code (second edition 2012) and global United Nations Principles of Responsible Investment (UNPRI) set out key principles of effective stewardship for asset owners to help them better to exercise their stewardship responsibilities.

3.6.3 Compliance with these UK and global sets of principles is not mandatory for Scheme funds but they have the support of the UK Government and Local Authority Pension Fund Forum (LAPFF).

3.6.4 As at 31 March 2018 some 28 (31%) were signatories to the Code and 8 funds (8%) (plus one pool company becoming a signatory in March 2018) were signatories to the UNPRI. Since March 2018, three more pool companies and the City of London Corporation have become signatories to UNPRI. The London CIV is a signatory to both.

3.7 Investment allocation

3.7.1 The table below shows the aggregated change in percentage asset allocation for the Scheme funds between 31 March 2017 and 31 March 2018.

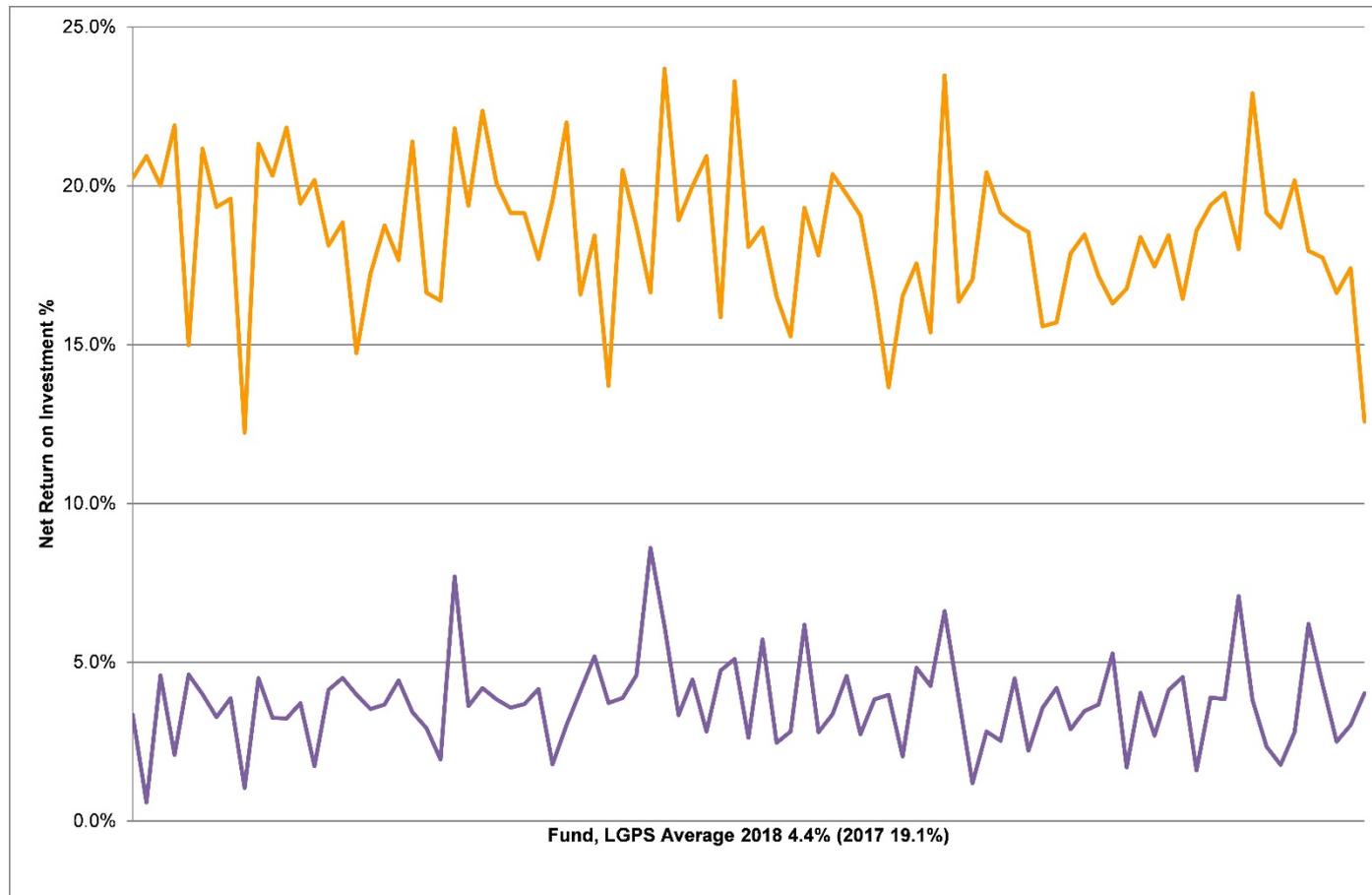
Table 3: Changes in Asset Allocation

Investment Assets	2017	2018	Change
Fixed interest securities	7.0%	6.7%	-0.2%
Equities	31.8%	28.5%	-3.2%
PIVS	47.3%	49.6%	2.3%
Property PIVs	47.3%	4.9%	0.3%
Derivatives	0.6%	0.2%	-0.4%
Property	2.7%	3.0%	0.3%
Other	1.1%	1.6%	0.5%
Private Equity	2.6%	2.6%	0.0%
Cash deposits	2.2%	2.6%	0.4%
Other balances	0.3%	0.4%	0.1%
Total	100.0%	100.0%	

3.8 Investment performance

3.8.1 The graph below shows the net return on investment based on aggregated Fund accounts for the years to 31 March 2017 (■) and to 31 March 2018 (■).

Chart 2: Net Investment Returns



3.8.2 The average return on investment, and total for the Scheme on an aggregate basis, for the year ended 31 March 2018 was 4.4% (2017 19.4%). The average investment expenses were 0.4% over the period (2017 0.4%), giving a net return on investment of 4.0% (2017 19.0%).

3.8.3 The market commentary in paragraphs 3.8.4 to 3.8.6 was provided by Pensions & Investment Research Consultants Ltd based on their Local Authority Pension Fund Performance Universe. This year's peer group results are based on a universe of 61 funds with a value of £177bn. This represents some two thirds of local authority pension fund assets and includes all of the Welsh and Northern Pools, all bar two of the London Pool, with funds from all other pools except Central.

3.8.4 Over the last twelve months the average local authority pension fund has returned 4.5%. This return is below the 30 year average of 8.9% p.a. but broadly in line with actuarial assumptions which are currently estimating around 4% p.a. Asset returns were tightly grouped with bonds, equities and alternatives returning 1%, 4% and 6% respectively for the year. Strategic asset allocation therefore had less of an impact than usual - the range of individual fund returns was about half that seen in the year previous with almost all funds returning between 2% and 6% for the year.

UK equities underperformed all major overseas markets for Sterling investors. Active management also failed to add any value above the benchmark.

After struggling in 2016 to 2017 **active global equity** managers came back strongly in the last year. The average global equity portfolio outperformed the index by over 2% in the latest year. Baillie Gifford, the largest active equity manager across the Scheme, performed particularly strongly. The funds in the top decile of performance in the last year were all managed in part by Baillie Gifford.

Bond markets produced small positive returns. Those funds that invested in absolute return mandates produced better returns than those managed against market indices. Most bonds are managed on an active basis and the move towards absolute return portfolios (all of which are actively managed) has meant that the level of passive management within this group has declined further in the last year. Bond portfolios performed broadly in line with benchmarks with exception of overseas bonds where they comfortably outperformed.

Property was the best performing of the major asset classes returning 10% for the year. Most funds now have some exposure to this asset which enhanced overall returns.

- 3.8.5 In terms of asset allocation, this has remained broadly unchanged over the last decade - with equities remaining the dominant asset class in most fund's allocations. The reduction in the equity exposure was reduced at the fastest rate yet seen in the latest year. However, the Scheme is still substantially overweight in equities when compared with the corporate sector where schemes have sought to 'de-risk' their assets, moving instead to bonds and cash flow matching investments. The movements in allocation can be seen below.

Table 4: Movement in Asset Allocations

Allocation	31/3/2016	31/3/2017	31/03/2018
Equities	60	62	55
Bonds	16	15	18
Alternatives	9	10	11
Property	9	8	9
Cash	3	2	3
Diversified Growth	3	3	4

- 3.8.6 Longer term performance has been extremely strong over the medium and longer term. There have been only five years of negative performance in the last thirty, at the start of the millennium (the bursting of the dot-com bubble) and the global financial crisis (2008/09). All periods were followed by double digit returns. The equity 'shocks' that investors are so concerned about mitigating have been infrequent and the reward for holding equities substantial. The discrete period performance of local authority performance has been as below.

Table 5: Long Term Performance

% pa	3 Years	5 Years	10 Years	20 Years	30 Years
Average	8.3	8.8	7.7	6.5	8.9
Median	7.7	8.5	7.5	6.1	8.7
RPI	2.7	2.3	2.8	2.8	3.3
CPI	1.7	1.4	2.3	2.0	2.6

3.9 Financial statements

- 3.9.1 The Statement of Accounts summarises the Scheme's transactions for the year. The data used comes from the individual funds' financial statements which are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (The Code). The Code is issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and is based on International Financial Reporting Standards, as amended for the UK public sector. The individual fund accounts have been prepared on an accruals basis in accordance with the Code, apart from transfer values which are accounted for on a cash basis in accordance with the Code.
- 3.9.2 The Net Assets Statement, similarly summarises the Scheme's assets position at year end.

3.10 Auditor Statement

- 3.10.1 Each Scheme fund is subject to an annual statutory external audit of its financial statements that must be prepared in accordance with Scheme regulations and CIPFA guidance. The Scheme Advisory Board is keen that all funds publish their statutory annual report and audited financial statements by 30 September and at the latest by 1 December each year. The latter was largely achieved in 2018 other than by a small number of funds whose reports were not published until after the deadline.
- 3.10.2 The Scheme financial audits are the responsibility of three statutory auditing bodies – the Public Sector Audit Appointments Limited (PSAA) (the Audit Commission up to 31st March 2014) and National Audit office for 83 LGPS funds based in England; and Welsh Audit Office for 8 LGPS funds based in Wales. They are required to give assurance (or otherwise) that the financial statements show a true and fair view of the fund income and expenditure and of the amount and disposition of the fund assets and liabilities.

3.10.3 Audits were carried out by the following:

Auditor	Number of audits
National Audit Office	2
Grant Thornton	32
Deloitte	7
Ernst & Young	23
BDO LLP	6
Mazars	11
Welsh Audit Office	8
TOTAL	89

3.11 Advisor Statements

3.11.1 UK pensions law requires those charged with the governance of occupational pension schemes and pension funds to take professional advice in respect of their fiduciary duties towards beneficiaries.

3.11.2 During 2017/18 the Scheme administering authorities all received advice from external auditors and, as they deemed appropriate, from a range of specialist external advisors in respect of:

- Administration
- Asset custody
- Actuarial
- Benefits
- Investment
- Legal
- Other

4 DATA PROTECTION IMPLICATIONS

4.1 Will the subject of the Report involve the processing of “personal data?”

No

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BACKGROUND DOCUMENTS:

None.