Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE & CORPORATE RESOURCES		
Pension Fund – Quarterly Update **Pensions Committee** **18th December 2019**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **FIVE** **AGENDA ITEM NO.**

1. INTRODUCTION

1.1 This report is an update on key quarterly performance measures, including an update on the funding position, fund governance, investment performance, responsible investment, budget monitoring, administration performance and reporting of breaches.

2. RECOMMENDATIONS

2.1 The Pensions Committee is recommended to note the report.

3. RELATED DECISIONS

- Pensions Committee 29th March 2017 –2016 Actuarial Valuation and Funding Strategy Statement
- Pensions Committee 29th March 2017 –Investment Strategy Statement
- Pensions Committee 26th March 2019 –Pension Administration Strategy (PAS)

4. COMMENTS OF THE GROUP DIRECTOR OF FINANCE & CORPORATE RESOURCES

4.1 The Pensions Committee has delegated responsibility for management of the Pension Fund. Quarterly monitoring of key aspects of the management of the Pension Fund is good practice and assists the Committee in making informed decisions. .

4.2 Monitoring the performance of the Fund's investment managers is essential to ensure that managers are achieving performance against set benchmarks and targets. Performance of the Fund's assets will continue to have a significant influence on the valuation of the scheme's assets going forward. The investment performance of the Fund is a key factor in the actuarial valuation process and therefore directly impacts on the contributions that the Council is required to make into the Pension Scheme.

4.3 The Committee's responsibilities include setting a budget for the Pension Fund and monitoring financial performance against the budget. Quarterly monitoring of the budget helps to ensure that the Committee is kept informed of the progress of the Fund and can provide the Committee with early warning signals of cashflow issues and cost overruns.

4.4 Reporting on administration is included within the quarterly update for Committee as best practice. Monitoring of key administration targets and ensuring that the administration functions are carried out effectively will help to minimise costs and ensure that the Fund is achieving value for money.

4.5 Whilst there are no direct impacts from the information contained in this report, quarterly monitoring of key aspects of the Pension Fund helps to provide assurance to the Committee of the overall financial performance of the Fund and enables the Committee to make informed decisions about the management of the Fund.

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE

5.1 The Pensions Committee's Terms of References sets out its responsibility for management of the Pension Fund. The Committee has delegated responsibility:

- To make arrangements for the triennial actuarial valuation, monitor liabilities and to undertake any asset/liability and other relevant studies as required.
- To monitor the performance and effectiveness of the investment managers and their compliance with the Statement of Investment Principles (Investment Strategy Statement).
- To set an annual budget for the operation of the Pension Fund and to monitor income and expenditure against budget.
- To act as Scheme Manager for the Pension Fund

5.2 Given these responsibilities, it is appropriate for the Committee to consider a regular quarterly update covering funding and investment matters, budget monitoring and scheme administration and governance.

6. FUNDING UPDATE

6.1 The Fund's actuary, Hymans Robertson, provides a quarterly update on the funding position of the Fund illustrating how the overall position has changed since the last actuarial valuation. The results below have been presented on the basis of the 2016 valuation, using rolled forward assumptions updated for changes in gilt yields. They therefore look very different from the initial results of the 2019 valuation, which uses updated actuarial assumptions and information on the membership of the fund.

6.2 The changes made for the 2019 include changes in demographic and longevity assumptions, as well as a change in the approach to setting the discount rate. The Fund's discount rate in 2016 was based on gilts plus 1.65%, which means that the monitored funding level fluctuates with gilt yields. The discount rate for the 2019 valuation has been calculated based on the fund's investment strategy and expected returns, so is less strongly correlated to movements in gilt yields. More information on the changes for the 2019 valuation can be found in the 'Actuarial and Funding Strategy Statement' paper.

6.3 As at the end of September 2019, the funding level based on the 2016 valuation was 75.7% compared to 77% as at the end of March 2016. This represents a slight decrease relative to the previous quarter (77.6%).

6.4 The funding level of 75.7% at 30th September 2019 is based on the position of the Fund having assets of £1,651m and liabilities of £2,179m, i.e. for every £1 of liabilities the Fund has the equivalent of 75.7p of assets. The monetary deficit remains high, increasing from £350m in March 2016 to £528m in June 2019. The liabilities are a summation of all the pension payments which have been accrued up to the valuation date in respect of all scheme members, pensioners, deferred members and active members. These will be paid over the remaining lifetime of all members, which could stretch out beyond 60 years. The actuary then calculates the contributions which would be required in order for the Fund to meet its liabilities in respect of benefits accruing and to recover any deficit which has arisen.

6.5 The progress of the funding level on both an ongoing and yield curve basis is shown in the Funding Progression Update on Page 4 of the Investment Performance and Funding Report at Appendix 1. As stated above, this information is provided on a different basis to that discussed as part of the 2019 valuation – more information is provided in the Valuation Report. The report also highlights the asset risks to which the Fund is exposed, providing a basic breakdown of the Fund's asset allocation along with returns of major asset classes since 31st March 2016**.**

7. GOVERNANCE UPDATE

7.1 During Q1, officers of the Fund provided responses to a governance survey issued by Hymans Robertson. The survey was commissioned by the LGPS Scheme Advisory Board and asked respondents to consider the governance of the LGPS and potential conflicts of interest between the pensions function of administering authorities and their host local authority. The survey focused on financial decision-making and the role of the s151; officers considered that a number of the suggestions represented good practice (e.g. approval of pension fund budgets by pensions committees) but recommended against radical change to existing structures.

7.2 The responses to the survey and Hymans Robertson's initial report have now been considered by the Scheme Advisory Board (SAB). A Phase II report has now been published on the SAB website. The report sets out a number of recommendations across 2 workstreams; Standards & Outcomes and Compliance & Improvement. The SAB has also agreed that the Secretariat, in conjunction with the project team at Hymans Robertson and scheme stakeholders, should proceed to develop Phase III of the project including draft statutory guidance on governance compliance statements and establishing a set of key performance indicators. Final proposals for Phase III of the project will be considered by the Board when it next meets on the 3rd February 2020.

7.3 The Pensions Regulator recently completed an engagement exercise with 10 local government funds from across the UK. The exercise was completed between October 2018 and July 2019 following the results of the Regulator's governance and administration survey, which suggested that the rate of improvement across the LGPS had slowed down. The aim of the exercise was to understand scheme managers' approaches to a number of key risks, feedback on good practice and suggest improvements that could be made.

7.4 The Regulator has now produced a report on its findings which highlights key risks, sets out examples of good practice and suggests areas in which improvements can be made. Officers of the Fund have reviewed the report and considered areas in which the Hackney Pension Fund is performing well and those in which improvements could be made. These are summarised in the Pensions Board report below: http://mginternet.hackney.gov.uk/documents/s67691/4%20-%20Review%20of%20the%20Pensions%20Regulators%20Work%20-%20Update%20and%20Training.pdf

8. INVESTMENT UPDATE

8.1 Appendix 2 to this report provides a manager performance update from the Fund's Investment consultants, Hymans Robertson. The report includes an analysis of quarterly, 1 year and 3 year performance against benchmark, as well as Hymans Robertson's current ratings for each manager.

9. RESPONSIBLE INVESTMENT UPDATE

9.1 The Pensions Committee has looked to increase the level of engagement with the underlying companies in which it invests. This includes taking a more proactive role in encouraging managers to take into consideration the voting recommendations of the Local Authority Pension Fund Forum (LAPFF). This section of the quarterly report therefore provides the Committee with an update on the work of the LAPFF and also voting recommendations and how managers have responded. In addition the update will include key topical issues concerning environmental and social governance issues in order to provide scope for discussion on these key issues.

9.2 The LAPFF Quarterly Engagement report is attached at Appendix 3 to this report, setting out LAPFF's engagement activity over the Quarter in relation to environmental, social and governance issues. Following the restructuring of its equity portfolio, the Fund no longer retains any segregated mandates and therefore has no direct holdings in the companies referenced. It does, however, retain exposure via its pooled passive funds to a large number of the companies LAPFF engages with.

9.3 During the quarter, changes to secure investment in the Just Transition were discussed at the Liberal Democrat, Conservative and Labour conferences. In his role as Vice-Chair of LAPFF, Pensions Committee Chair Cllr Rob Chapman has helped drive LAPFF's role in the Just Transition, emphasising that partnership is critical to its success. Organised by the Smith Institute, the meetings provided a platform for LAPFF to set out what these changes should be. A core recommendation from LAPFF was that the UK government should establish a Just Transition Commission, along the lines of the Scottish Commission, to bring public and private sectors together.

9.4 As set out in the Q2 update, Cllr Chapman represented the LAPFF at ArcelorMittal's AGM, welcoming the progress made by the company during the year towards development of a strategy consistent with the goals of the Paris Agreement and asking that scenario planning be developed to allow for a range of policy and climate positions including a 1.5 degree scenario.

9.5 Since the AGM, ArcelorMittal has brought out its first Climate Action Report which sets out the company's ambition to significantly reduce CO2 emissions globally and be carbon neutral in Europe by 2050. LAPFF met with senior executives of ArcelorMittal in early July, following the publication of the report. A summary of progress is provided below:

- **The commitment**: ArcelorMittal has committed to carbon neutrality in Europe by 2050 and to substantial reductions globally.
- **How the company plans to achieve it:** the Climate Action report has quite detailed low emission technology pathways, with the commercial time horizon for each set out.
- **Target setting:** the meeting had a strong focus on target setting, which ArcelorMittal aim to do in 2020, when the methodology for science-based targets for the steel industry is released. The current target is for an 8% carbon footprint reduction by 2020, against a 2007 baseline.
- **Limitations:** Lakshmi Mittal, ArcelorMittal's joint chair, chief executive has been very clear on his view for the need for a green border tax to make implementation of many of the low carbon technologies commercially viable.
- **Focus for future engagement:** as with other Climate Action 100+ engagements, trade association memberships and target setting are key themes. Company participation in the Energy Transitions Commission, which had been a request at the AGM, has emphasised the view of the need to move to hydrogen technology using renewable energy. ArcelorMittal has already launched a new project in Hamburg to use hydrogen on an industrial scale for the direct reduction of iron ore in the steel production process.

10. RISK MONITORING

10.1 Quarterly risk monitoring for Q2 2019/20 is included at Appendix 5. The reports cover the key risks faced by the Fund across 3 categories – Investment & Funding, Admin & Comms, and Governance. The reports highlight key and new risks, as well as any that have changed status relative to their target during the quarter.

10.2 Key risks - the Fund's key risks are as follows:

- Asset risk - failure to meet objectives through poor asset performance
- Funding risk - the growth rate of liabilities outstrips that of assets
- Poor membership data - poor administration or employer data provision resulting in inaccurate member records

The Fund's key risks are mostly unchanged since the previous review; however, the likelihood rating of 'Poor membership data' has improved from 'almost certain' to 'likely'

10.3 New/emerging risks - No new risks have been added since the previous review. However, the wording and actions on 'Reliance on external systems' have been changed to better reflect the risk of cybercrime and the actions to be taken to prevent it. This change has been made in line with recommendations from the Pensions Regulator

10.4 Deteriorating risks - no risk ratings have deteriorated since the previous review.

10.5 The Fund's full risk register (broken down by governance, funding & investment and administration & communications risks can be found at Appendix 5 to this report. The register assesses risks relative to the target level of risk which the Fund is willing (or required) to accept. The risk register was last updated in September 2019.

11. BUDGET MONITORING

11.1 Budget Monitoring for Q2 2019/20 is presented at Appendix 6 to this report. The monitoring forecasts a reduced surplus on dealings with members relative to budget (£16.1m against a budgeted £20.9m). The key drivers behind this forecast reduction are transfers in and transfers out; the forecast for transfers in is significantly lower than budgeted (£6.1m against a budgeted £8.8m) whilst transfers out are forecast at £6.6m against a budget of £4.2m. It should be remembered that both items are entirely dependent on member decisions and are highly volatile as a result; these forecasts are likely to change significantly over the course of the year.

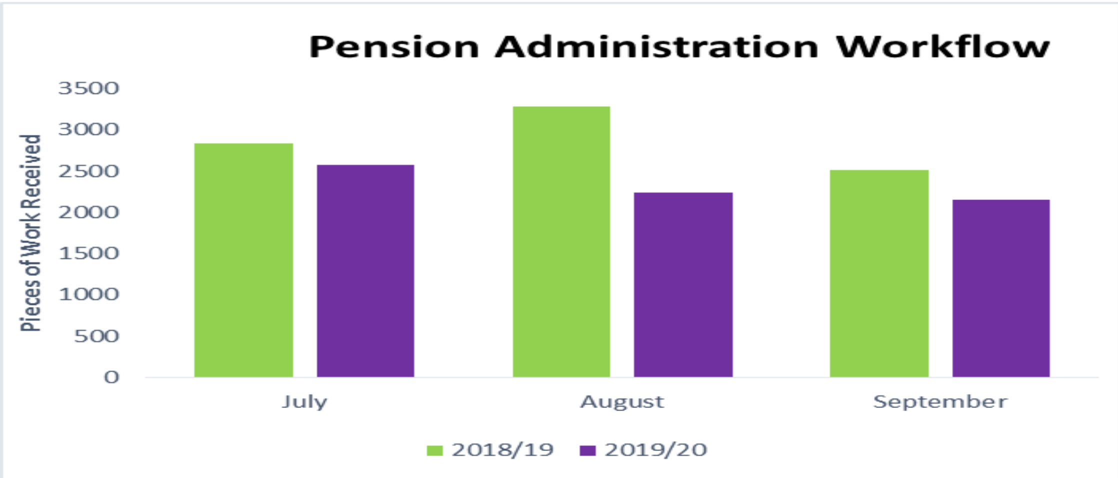
11.2 Certain items, most notably investment income and investment management fees, are still being forecast using the original budget estimates. Making a reliable estimate of investment costs and income is challenging at this relatively early stage in the year, given that both are dependent to a certain extent on investment performance.

.

12. PENSION ADMINISTRATION

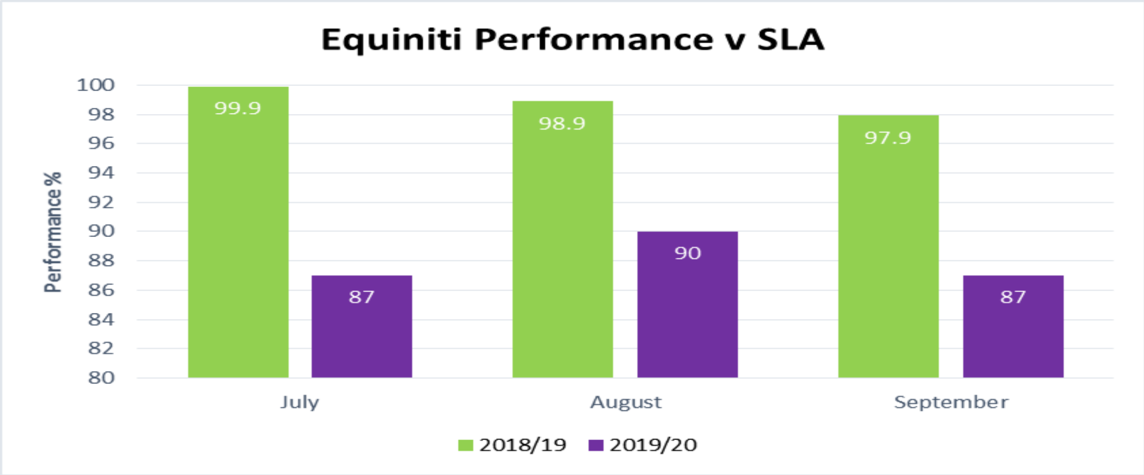
12.1 **Pension Administration Management Performance**

During Q2 2019/20, the administrators received a total of 6,964 new cases compared to 8,630 during Q2 in 2018/19. A comparison of the monthly workflow between Q2 2018/19 and the reporting quarter is set out below:-



The performance of the external pension administrators is monitored by the administering authority's pension team at Hackney on a monthly basis. As reported in previous quarters, Equiniti remain working under a 'relaxed SLAs' regime due to the ongoing data corrections and annual benefits statement validations taking priority over the business as usual (BAU).

Therefore performance against the service level agreement (SLA) is being monitored against priority work only (death grants, bank detail changes, pension into payment; i.e. all work relating to financials), and averaged 88% for Q2 2019/20, compared to 98.9% for the same quarter last year. The administrator's monthly performance against the SLA during Q2 2019/20 and Q2 of 2018/19 is set out below:



By 31st August 2019, the Fund had sent out 6,664 annual benefit statements to deferred members, with 1,622 statements withheld due to address or data issues. A total of 5,779 benefit statements were sent to active members, and 466 statements were withheld due to complex data issues. This represents a very significant improvement to the numbers issued for the year ending 2018. The key driver of this improvement was the receipt of high quality year end data files from Hackney Council and Hackney Learning Trust; although submitted late, the data was of good quality and allowed the majority of active statements to be sent.

During August 2019, Equiniti and the administering authority's pension team carried out a significant data cleansing exercise to help rectify errors and omissions and resolve complex cases to allow the outstanding statements to be sent out. This work required significant internal resourcing from the pension administration team as well as additional work by Equiniti. Where appropriate, additional costs have been met by Hackney Council as the employer.

At the time of writing this report (December 2019) the Fund has sent out statements to all but 30 active members and 160 deferred statements remain outstanding. These more complex cases are currently being investigated by Equiniti and statements will be sent out as soon as possible.

12.2 New Starters and Opt-Outs

	Total Active Membership at end of Quarter	Total Opt Outs for Quarter
Q2 2019/20	6,869	436
Q2 2018/19	6,857	126

The number of opt outs in Q2 2019/20 were significantly higher compared to Q2 2018/19, as on 1 July 2019 the Council undertook its mandatory Re-Enrolment duties, and as the London Borough of Hackney is also the employer of staff in Community and Voluntary Controlled Schools for the purposes of AE, it took the lead on behalf of these schools re-enrolment duties as well. This meant automatically re-enrolling "eligible job holders" - employees who are aged between 22 years and State Pension age (SPA) and to whom they pay gross earnings above the personal allowance threshold – who had previously opted out of a pension scheme, into a "qualifying" pension scheme on 1 July.

12.3 **Ill Health Pension Benefits.**

The release of ill health benefits fall into 2 main categories, being those for deferred and active members. The administration team at Hackney process all requests for the release of deferred members' benefits on the grounds of ill health, as well as assisting the Council's Human Resources team with the process for the release of active members' benefits on the grounds of ill health.

Deferred members' ill health benefits are released for life and are based on the benefits accrued to the date of leaving employment, with the addition of pension increase, but they are not enhanced by the previous employer.

Active members' ill health pensions are released on one of three tiers:

- Tier 1 - the pension benefits are fully enhanced to the member's normal retirement date and is typically only paid to those with very serious health conditions or life limiting health problems – paid for life, no review

- Tier 2 – the pension benefits are enhanced by 25% of the years left to the member's normal retirement date - paid for life, no review

- Tier 3 - the pension benefits accrued to date of leaving employment - paid for a maximum of 3 years and a review is undertaken once the pension has been in payment for 18months.

For tier 3, a scheme member's prognosis is that whilst they are unable to fulfil their current role on medical grounds to retirement, they may be capable of undertaking some form of employment in the relatively near future. However should the member's health deteriorate further, there is provision under the regulations for their benefits to be uplifted from tier 3 to tier 2, if the former employer agrees that their health condition meets the qualifying criteria for the increase.

The table sets out the number of cases that have been processed during Q2 of 2019/20, compared to the same period in the previous year:-

DEFERRED MEMBER'S ILL HEALTH RETIREMENT					
	CASES RECEIVED	SUCCESSFUL	UNSUCCESSFUL	ONGOING	WITHDRAWN
Q2 2019/20	1	0	0	0	1
Q2 2018/19	1	0	0	1	0

ACTIVE MEMBER'S ILL HEALTH RETIREMENT CASES					
	CASES RECEIVED	BENEFITS RELEASED ON TIER 1	BENEFITS RELEASED ON TIER 2	BENEFITS RELEASED ON TIER 3	UNSUCCESSFUL
Q2 2019/20	2	2	0	0	0
Q2 2018/19	0	0	0	0	0

12.4 **Internal Disputes Resolution Procedure (IDRP)**

This is the procedure used by the Fund for dealing with appeals from members both active and deferred. The majority of the appeals are in regard to either disputes around scheme membership or the non-release of ill health benefits. The process is in 2 stages:-

- Stage 1 IDRP's are reviewed and determinations made by a senior technical specialist at the Fund's pension administrators, Equiniti.
- Stage 2 IDRP's are determined by the Group Director, Finance & Corporate Resources taking external specialist technical advice from the Fund's benefits consultants.

There were no IDRP cases during the reporting quarter.

12.5 <u>**Other work undertaken in Q2 2019/20**</u>

<u>**Third Party Administration Implementation update**</u>

Good progress is still being made over the last quarter on finalising the delivery of the new contract specification. At the time of writing, (December 2019) there are now only 2 points of delivery on the new service specification that remain outstanding, and the agreed joint effort to get these delivered to the expected standard is proving productive and good progress is being made.

<u>**New & Ceasing Employers**</u>

During Q2, the Fund has not admitted any new employers and 1 employer contract has ceased; breakdown is as follows:

Employer	Date Joined	Date Ceased	Deficit upon Ceasing Y/N
Pride Catering – Nightingale School contract	-	31/08/2019	TBA

<u>**Voluntary Redundancy (VR) Exercises for the Council**</u>

In July 2019, the Council launched a VR scheme as an important initiative to help the Council make the necessary changes to help meet the financial challenge of funding cuts from central government. The voluntary redundancy scheme will help the Council reduce costs further and continue to protect services, and also minimise the amount of compulsory redundancies that may be need in the future.

The administering authority's pension team has taken the lead in this project and has provided redundancy, and a number of pension estimates, to c400 employees who have expressed an interest in the VR scheme. Corporate Panels have met to consider employees VR applications, and decision have been logged ready to release to applicants.

The decision letters will be available for applicants to collect week commencing 16 December, and their decision to accept or reject the Council's offer must be made by 6 January 2020. Those who accept the offer, will receive redundancy notices week commencing 13 January, their notice period to commence 20Janary and last day of service will be 29 February 2020, unless different dates have been agreed by the Panels taking account of service requirements.

Pre-retirement workshops

The in-house Pensions Team have set up a series of 'Pre-retirement workshops' in conjunction with a company called Affinity Connect. Affinity provide the facilitator, learning material and bookings for the seminars/workshops free of charge to the Fund and are aimed at members who are thinking of retiring within the next 2 to 5 years. The final workshop for this financial year is to be held on 13 January 2020.

13. REPORTING BREACHES

13.1 The breaches register for Q2 2019/20 is attached at Appendix 4 to this report. There were 9 breaches during the period, all relating to contributions or supporting documentation. All are rated green; none are considered reportable.

Ian Williams
Group Director of Finance & Corporate Resources

Appendices:

Appendix 1 – Investment Performance and Funding Report (Hymans Robertson – Investment Consultant)
Appendix 2 – LAPFF Quarterly Engagement Report
Appendix 3 – Breaches Register
Appendix 4– Risk Reporting
Appendix 5 – Budget Monitoring

Report Originating Officers: Rachel Cowburn □020-8356 2630
Financial considerations: Michael Honeysett □020-8356 3332
Comments of the Director of Legal and Governance: Sean Eratt □020-8356 6012