

ANNUAL REPORT OF THE PENSION FUND PANEL 2019-2021

(Meetings held on 21 June, 12 July and 20 September 2019
and 28 February and 29 June 2020)
(Also a training meeting held on 17 September 2019)

1. Appointment of Chair and Vice-Chair

Councillor J. Watson was appointed Chair and Councillor D. Kennedy was appointed Vice-Chair of the Pension Fund Panel (*“the Panel”*) in the 2019/20 Council year. These appointments continued during the 2020/21 Council year due to the COVID-19 pandemic.

2. Merger of Northumberland County Council Pension Fund with Tyne and Wear Pension Fund

In June 2019 the Panel formally agreed to recommend merger of Northumberland County Council Pension Fund (*“NCCPF”*) with Tyne and Wear Pension Fund (*“TWPF”*) to NCC’s Cabinet and the Council. This decision followed an informal Panel meeting, held in March 2019, in which the Panel had considered the pros, cons and risks of pursuing merger.

In January 2020, following due consideration by NCC’s Executive and Cabinet, the Council unanimously agreed to pursue merger. The Council delegated merger implementation to the Panel, subject to the satisfactory conclusion of the due diligence process.

Recognising that most of the savings from merger accrue to NCCPF’s employers via a lower expense loading element of the employers’ contribution rates, the Panel agreed cost sharing principles with TWPF where NCCPF bore the costs of implementation. These principles were embodied in the Merger Agreement between NCCPF, TWPF and the Council, finalised in March 2020.

Estimated project implementation costs were £0.5 million, with £1.0 million for transaction costs to reposition NCCPF investments in line with TWPF’s target asset allocation. Set against the expected savings for NCCPF employers of £0.5 million per annum, a payback period of about three years was anticipated.

The Ministry of Housing, Communities and Local Government (*“MHCLG”*) launched the formal consultation in March 2020 on the draft NCCPF/TWPF Merger Regulations required to effect merger.

The Panel acknowledged a small risk of annulment of the Merger Regulations after the coming into force date, and requested that TPWF take full responsibility for the former NCCPF assets (including trading those assets, if appropriate) with effect from the coming into force date.

The Local Government Pension Scheme (Northumberland and Tyne and Wear Pension Fund Merger) Regulations 2020 (SI 2020 No 502) came into force on 3 June 2020 giving merger retrospective effect from 1 April 2020. All assets and liabilities of NCCPF became the assets and liabilities of TWPF on 1 April 2020, and therefore NCCPF's final day as a reporting entity was 31 March 2020.

The Council ceased to be a LGPS Administering Authority from 3 June 2020, though the Panel remained in place, for a short period, to oversee the remaining steps of merger implementation.

Post-merger

The merger process went smoothly. Some investment transition costs could be incurred up to ten years after merger, but the estimated payback period is now considerably less than the originally anticipated three years.

3. NCCPF actuarial valuation as at 31 March 2019

During 2019/20, Panel members received the initial, provisional and final results of the 31 March 2019 actuarial valuation of NCCPF. The 31 March 2019 valuation set the contribution rates for participating employers for the three years 2020/21, 2021/22 and 2022/23, and was finalised in March 2020.

In September 2019, at a separate training meeting, the actuary presented the initial results of the 2019 NCCPF actuarial valuation to the Panel and the NCC LGPS Local Pension Board ("**the Board**") to obtain the Panel's views in setting the parameters for use in the valuation. This determined the level of prudence within the 2019 valuation, with a discount rate of 4.1% for the main employers in the Fund, a maximum deficit recovery period of 17 years, and an allowance made for the remedy to be agreed (nationally) in relation to the McCloud case.

NCCPF's funding level increased from 84% as at 31 March 2016 to **99%** as at 31 March 2019, despite increased prudence within the valuation. The funding level improved mainly because Fund returns (11.2% p.a. for the three years to 31 March 2019) exceeded the assumption of 4.4% p.a. underlying the 2016 valuation. Given the improved funding level, the Panel took the opportunity to increase the prudence in the funding basis at 2019.

The Panel reviewed the covenant risk of all employers participating in NCCPF as at 31 March 2019 before finalising the valuation.

4. Border to Coast Pensions Partnership (BCPP) pooling arrangement

In 2015 the Government announced plans to ensure LGPS administering authorities would pool their LGPS investment assets to comply with criteria set out in Guidance published in November 2015. In January 2019, Government consulted on replacing the November 2015 Guidance, then withdrew this proposal following concerns raised in responses to the consultation.

In February 2017, to satisfy the Government's pooling agenda, the Council gave approval to NCCPF investing in and jointly owning Border to Coast Pensions Partnership ("**BCPP Ltd**") with eleven other LGPS funds, including TWPF.

During 2019/20 members or officers (as appropriate) attended all meetings of the BCPP Officer Group and BCPP Joint Committee (“**JC**”), working with the other authorities to develop BCPP Ltd and its range of sub funds. The Chair of the Panel was appointed as non-executive director of BCPP Ltd in February 2020, and stepped down from the BCPP JC.

NCCPF did not transfer any assets to BCPP Ltd’s management, initially because BCPP Ltd’s sub fund range available was not suitable for NCCPF’s investment strategy, and later due to the (then) planned merger with TWPF.

The original agreement NCCPF and others entered into when committing to the BCPP pooling arrangement allowed for the NCCPF/TWPF merger. Therefore NCCPF exited the arrangement, upon merger, without financial penalty.

5. Shared pensions administration service with TWPF provided by South Tyneside Council

Working with the Board, the Panel monitored the shared pensions administration service provided by South Tyneside Council (“**STC**”) during 2019/20, to ensure it delivered an effective and efficient service.

The Panel received STC’s internal audit report which gave assurances regarding the shared service’s compliance with the General Data Protection Regulation.

6. Quarterly monitoring of investments with information from Mercer, the Fund’s investment managers and the performance measurement service provider

The Panel received quarterly performance information, Mercer’s research and ratings of the Fund’s investment managers, and presentations from selected managers following an agreed programme.

At the currency hedging review undertaken by Mercer in February 2020, the Panel agreed to retain the Fund’s partially hedged position.

The Panel received information from the performance measurement service provider, Portfolio Evaluation, about NCCPF’s performance in the one, three five and ten years ending 31 March 2019, with market commentary, comparisons to other pension fund investors and attribution analysis.

7. Action Plan 2019 for NCC Pension Fund

The Panel delegated to the Service Director – Finance in consultation with the Chair and Vice Chair of the Panel to agree the Action Plan 2019 for the Fund. The Plan was finalised in October 2019 following the Cabinet’s consideration of merger.

8. Investment strategy review

In July 2019, the Panel considered NCCPF’s 2019 investment strategy review, which had been undertaken by Mercer. The purpose of a strategy review is to consider the appropriateness of the Fund’s current asset allocation and to set the long term strategic allocation for the future.

Due to the imminence of merger and time it would take to build up allocations to illiquid assets, the Panel made no changes to the Fund's strategic target asset allocations save for altering the geographical split of the publicly quoted equities.

The Panel amended the Fund's target allocation to equities to reduce the exposure to publicly quoted UK equities, as follows:

Quoted equities	Previous allocation %	New target allocation %
UK	24.0	12.0
US	7.0	9.6
Europe	7.0	9.0
Japan	3.5	7.2
Asia Pacific ex Japan	3.5	7.2
Emerging Markets	7.0	7.2
RAFI 3000 (global)	<u>8.0</u>	<u>7.8</u>
Of total Fund value	<u>60.0</u>	<u>60.0</u>

9. RPI consultation and potential impact on NCCPF's index-linked gilts

The Panel received information about the Government's anticipated consultation on a change to the inflation linkage, from RPI to CPI, on index-linked gilts (ILG), and the likely impact on the value of NCCPF's holdings in ILG. Mercer's view at that time was that there was a risk that the value of ILG would fall, though the scale and timing of that fall could not be predicted.

The Panel agreed to Mercer's recommendation to move 50% of NCCPF's holdings in ILG into Legal and General's Investment Grade Credit index fund (LGIM's IGC).

Mercer recommended moving into LGIM's IGC, as opposed to an alternative suitable asset class with similar defensive characteristics, because TWPF's long term plan, post-merger, was to move part of the former NCCPF assets out of ILG into LGIM's IGC. Therefore, anticipated transition costs to implement merger would be incurred earlier than previously expected, but double transition costs would be avoided.

The Panel amended the Fund's target allocation to bonds to reduce the exposure to ILG, as follows:

Bonds	Previous allocation %	New target allocation %
Index-linked gilts	15.0	7.5
Investment grade credit	<u>-</u>	<u>7.5</u>
Of total Fund value	<u>15.0</u>	<u>15.0</u>

10. Review of AVC provision for NCCPF

The Panel received information about Hymans Robertson's formal review of the Fund's current Additional Voluntary Contribution ("**AVC**") provision. The Panel noted Hymans' overall conclusion that Prudential should be retained as the Fund's open AVC provider and agreed the recommended changes to the AVC fund range offering.

11. Northumberland County Council Pension Fund annual report and accounts

The Panel received the Fund's Annual Report and Accounts for the year to 31 March 2019 together with the external auditor's final report.

At the time of finalising this report, NCCPF's Annual Report and Accounts for the year to 31 March 2020 had not been signed off by external auditor, though the auditor's final report had been published.

12. Reports on internal controls operated by fund managers and the custodian

The Panel received information about the most recent internal control reports provided by the Fund's custodian and investment managers. These reports, prepared at least annually, describe the internal controls in place within the relevant financial institution to protect the interests of clients, including NCCPF.

13. Feedback from the NCC LGPS Local Pension Board

The Panel worked with the Board throughout the year, delegating detailed review of matters relating to LGPS administration, such as the code compliance checklist (see item 14, below), to the Board. The Board provided quarterly feedback with recommendations to the Panel, and an annual report.

14. The Pensions Regulator's code compliance checklist

The Panel received NCCPF's fourth annual assessment against the standards set out in the Pensions Regulator's Code of Practice Number 14.

15. The Pensions Regulator's "cohort review"

The Panel received information about the Pensions Regulator's report "*Governance and administration risks in public service pensions schemes: an engagement report*" (known as the cohort review) which was published in September 2019.

The cohort review took a year to complete, commencing in 2018. The Regulator engaged with ten LGPS administering authorities to examine their policies and practices. The engagement report analysed the findings and made 47 recommendations.

The Board considered the cohort review in detail, comparing NCCPF's policies and practices against the 47 recommendations, to identify any lessons to be learned or improvements to be made. The Board's review did not result in any proposals for change to NCCPF's policies and practices.

16. Scheme Advisory Board's review of LGPS governance

The Panel received a series of reports on the “*Good Governance Review*”, which was originally launched by the LGPS Advisory Board (“*the SAB*”) in 2018 then developed in phases during 2019. The Review’s purpose was to consider ways of raising standards of governance across the LGPS, identifying and managing conflicts of interest, and ensuring the Scheme is resourced to meet its regulatory obligations. Following a survey carried out in May 2019, the SAB concluded that there should be greater ring fencing of the LGPS within existing legal structures. In November 2019, the Phase II report made recommendations to implement the proposed new framework. Further detail was expected in Phase III (published February 2021) but no changes to NCCPF’s governance arrangements were indicated by the Review.

17. Review of MiFID II documentation and status

The Panel received a report which confirmed that, following a review in November 2019, there were no changes to NCCPF’s circumstances which should be notified to the relevant financial institutions because they could affect the professional client status opt ups (under MiFID II) that had already been confirmed to NCCPF by those financial institutions.

18. Monitoring of breaches of the law and KPIs

The Panel received quarterly monitoring reports of recorded breaches of the law and KPIs for NCCPF and delegated to the Board to conduct an in-depth review of both. During 2019/20, the Board, the Panel and officers of NCCPF identified no breaches which were, in their view, likely to be of material significance and therefore reportable to the Pensions Regulator.

19. Quarterly regulatory report

The Panel received the quarterly reports which are provided to STC’s Pensions Committee to keep members up to date with relevant LGPS regulatory changes.

20. Government consultations

The Panel considered Government consultations affecting the LGPS, and, where relevant, NCCPF’s response to those consultations. Those consultations not referred to elsewhere in this report were on:

- implementing, via secondary legislation, the £95,000 exit payment cap policy already set out in the Enterprise Act 2016, within public sector schemes;
- extending the Fair Deal Guidance to the LGPS; and
- changing the LGPS actuarial valuation cycle to four yearly to align the LGPS with the other public sector schemes to facilitate the operation of the cost cap mechanism.

21. NCCPF risk register

The Panel received the updated NCCPF risk register, restated to reflect NCC’s revised corporate risk management framework and risk scoring system, and a separate **merger risk register**, and delegated to the Board to conduct an in-depth review of both.

22. Updates to NCCPF's statutory policy statements

As required by the LGPS Regulations, NCCPF maintained and published certain written policy statements, consulting on changes where appropriate.

During 2019/20 the Panel approved changes as follows:

- **Funding Strategy Statement ("FSS"):** The FSS was amended before the 2019 actuarial valuation was finalised, setting out NCCPF's approach to
 - funding surplus amortisation (i.e. amortising the excess over 105% funded over a 20 year period)
 - funding deficit recovery (i.e. mainly recovering over the average future working lifetime to a maximum of 17 years)
 - making an allowance for the McCloud remedy uncertainty, and
 - imminent merger (i.e. clarifying that the certified contribution rates apply post-merger and NCCPF employers will meet certain merger related expenses); and
- **Investment Strategy Statement ("ISS"):** The ISS was updated to reflect changes made in 2019/20 to the target benchmark allocations to publicly quoted equities and bonds.

23. Updates to NCCPF's other (non-statutory) policy statements

The Panel delegated to the Service Director – Finance in consultation with the Chair and Vice Chair of the Panel to update the following policies:

- **Cash Pooling Policy;** and
- **Administering Authority Discretions Policy:** This Policy was aligned with TWPF's Discretions Policy, to assist in the efficient implementation of merger.

24. Training

The Panel reviewed the 2019/20 training records of the Panel and Board members, as well as officers involved in administering the LGPS at NCCPF.

The Panel and Board considered the results of the Fund's 2019/20 formal training needs analysis procedure.

25. Formal measurement of the performance of the investment adviser

Panel members conducted the annual formal assessment of the performance of the Fund's investment adviser, Mercer.

26. Formal measurement of the effectiveness of the Pension Fund Panel

The Panel considered its own effectiveness as a decision making body and approved a formal annual report assessing its effectiveness.

27. MHCLG statistical release 2018/19

Members received a report with details of the MHCLG statistical release on LGPS funds in England and Wales in 2018/19 which compared NCCPF information with other funds' information.

28. Cost cap mechanism/McCloud remedy

The Panel received information about the LGPS cost cap mechanism, which was due for implementation from April 2019 but paused by Government in January 2019 following the McCCloud judgement. The 2018 McCCloud judgement found the protections within the judges' and firefighters' 2015 pension schemes to be unlawful due to age discrimination. In July 2019, HM Treasury confirmed that the Government would implement remedies for the age discrimination across all 2014 and 2015 reformed public service pension schemes, including the LGPS.

The uncertainty of the potential additional liabilities from any future McCCloud remedy to be implemented in the LGPS was taken into account, based on the age profile of NCCPF's active membership, in the 2019 actuarial valuation.

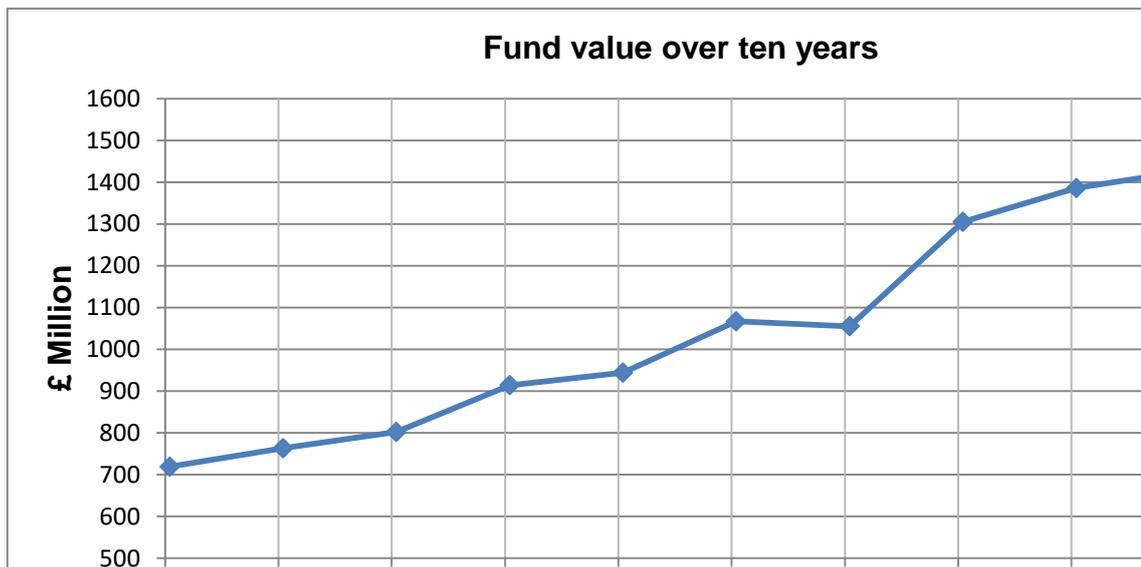
29. CMA changes to the investment consultancy market

The Panel received information about reforms in the investment consultancy market following publication, in June 2019, of the Competition and Markets Authority ("**CMA**") Order, and the implications for NCCPF. To comply with the Order, in December 2019 NCCPF set strategic objectives for its investment adviser, Mercer.

30. Fund value

The Panel received quarterly performance information for the Fund as a whole and for each fund manager, as well as the total Fund value analysed by asset class. The value of the Fund at the last ten year-ends are shown below:

	Fund value (£m)
31 March 2020 (audit not yet finalised)	1,400
31 March 2019 (audited)	1,428
31 March 2018 (audited)	1,386
31 March 2017 (audited)	1,305
31 March 2016 (audited)	1,055
31 March 2015 (audited)	1,067
31 March 2014 (audited)	944
31 March 2013 (audited)	914
31 March 2012 (audited)	802
31 March 2011 (audited)	763
31 March 2010 (audited)	719



The Fund's investment return over the ten years to 31 March 2020 was **6.7% per annum**, significantly above returns from cash, and salary and retail inflation.

31. Impact of Coronavirus Disease 19 (COVID-19)

The Fund value fell sharply in February and March 2020, following strong performance from April 2019 through to early February 2020. From the peak in early 2020, financial markets suffered sharp falls due to world-wide economic shutdown in response to the COVID-19 pandemic.

The LGPS is an open scheme underpinned by employers of strong covenant, and invested for the long term. As such, LGPS funds are in a good position to weather downturns in financial markets.

However, the Fund's Actuary highlighted that should markets fail to recover there will be upward pressure on employer contributions at the 2022 valuation, which participating employers (including the Council) should note.

32. Guarantees

The Panel agreed that NCC should provide pension guarantees to TWPF in respect of six employers participating in the former NCCPF.

33. Final meeting of the Pension Fund Panel

NCCPF (in effect) ceased to exist from 1 April 2020. The Panel's final meeting was in June 2020, with the Board's final meeting in July 2020. Following merger, the Council now has representation on the TWPF Pensions Committee.

Councillor Jeff Watson
Chair of the Pension Fund Panel

[Acknowledgements](#)

The Chair thanked the members of the Panel and NCC LGPS Local Pension Board for their hard work and continued collaborative working throughout 2019/20/21, and the Pensions Team for the guidance and advice he received.