Merton Council

Pension Fund Investment Advisory Panel Agenda

Membership

Councillors:

Cllr: Laxmi Attawar (Chair)
Cllr: Tobin Byers (Vice Chair)
Cllr: Adam Bush
Gwyn Isaac (GMB Rep)
Tina Pickard (Pensioner Rep)
Caroline Holland (LBM)
Roger Kershaw (LBM)
Nemashe Sivayogan (LBM)

Additional Attendees
Mercer – Investment Consultants
Barnet Waddingham – Fund Actuary

Date: **Wednesday 25 November 2020**

Time: **6.00 pm**

Venue: **Online**

This is a public meeting and attendance by the public is encouraged and welcomed. For more information about the agenda please contact Merton.PensionFund@merton.gov.uk or telephone 020 8545 3458.

All Press contacts: communications@merton.gov.uk, 020 8545 3181

Pension Fund Investment Advisory Panel Agenda
25 November 2020

Note on declarations of interest

Members are advised to declare any Disclosable Pecuniary Interest in any matter to be considered at the meeting. If a pecuniary interest is declared they should withdraw from the meeting room during the whole of the consideration of that mater and must not participate in any vote on that matter. For further advice please speak with the Managing Director, South London Legal Partnership.

Merton Pension Fund Advisory Panel

Minutes of the meeting held on 10 September 2020 (Virtual Meeting)

Attendance:

Cllr. Owen Pritchard (Chair),
Cllr Adam Bush (Vice Chair)
Cllr. Mark Allison
Gwyn Isaac (GMB Union Rep)
Tina Pickard (UNISON Rep)
Caroline Holland (LBM)
Roger Kershaw (LBM)
Nemashe Sivayogan (LBM)

Additional Attendees
Aniket Bhaduri and Ross Palmer - Mercer Investment Consultant
Suresh Patel- Ernst & Young

1.0 MEETING (Part 1)

1.1 Introductions made by Chair.

1.2 Members Declaration of Interest – None.

2. Minutes of Last Meeting Held (Part 1) – 21 July 2020 (Decision making)

2.1 It was noted that there was an error on the attendee list. The attendees should have been as follows:

Cllr. Owen Pritchard (Chair), Cllr. Adam Bush (Vice Chair), Cllr. Mark Allison, Tina Pickard (Pensioner Rep), Gwyn Isaac (GMB Union Rep) Caroline Holland (LBM), Roger Kershaw (LBM),Nemashe Sivayogan (LBM)

2.2 The actual minutes were agreed as a true record.

3.0 **Merton Pension Fund –Audit Report- Ernst and Young. Quarterly Fund**

3.1 SP stated the Pension Fund audit is near complete and the audit report will be updated to reflect any changes due to the outstanding queries. Audit took longer than usual due to testing on triennial data. There was a focus on 'Going Concern', disclosed as a Post Balance sheet event .Currency hedging was new this year .

4. Quarterly Fund Performance Review (April 2020 to June 2020) (For Information)

4.1 Over the 3 months to 30 June 2020, total Fund assets returned 14.1% compared to the target of 1.2%. This equates to an outperformance of 12.9%.

4.2 The Fund's total market value increased by £96m over the quarter, from £689m to £785m. Over the last 12 months, the Fund performance was 4.2%, and 3 year annualised performance was 5.9%. The annual performance target is 4.8%.

4.3 Cllr Pritchard commented on the resilience of the Fund and how it had bounced back to an all-time high.

5. AOB

5.1 None

Committee:

Pension Fund Advisory Panel — Date: 25 November 2020

Merton Pension Board — Date: 14 December 2020

Wards: All

Subject: Merton Pension Fund Performance – September 2020

Lead officer: Caroline Holland - Director of Corporate Services

Lead member: Councillor. Mark Allison.

Contact officer: Roger Kershaw- AD Resources

This is a Public Document

RECOMMENDATION
Members are asked to note the content of this report, in particular, the market values and performance of the total Fund and component portfolios for the quarters ending 30 September 2020, attribution of the results and the market environment during the period.

1.0 PURPOSE OF REPORT

1.1 To report the investment performance at total Fund level, and of the individual fund managers, for the quarter ending 30 September 2020. The report highlights the performance of the total Fund by asset class compared to the customised benchmark.

1.2 The report gives the Committee a consistent basis on which to review the performance of the Fund as at 30 September 2020. The report provides information to support future actions including periodic rebalancing and review of investment strategy and investment management arrangement.

2.0 FUND PERFORMANCE

2.1 The attached Fund Analysis & Performance Report (**Appendix 1**) produced by the Fund's investment and performance consultants Mercer provides useful analysis and insights of the Pension Fund activities and results for the quarters ending September 2020.

The table below shows the total fund valuation and the movements in investments during the quaterended Sept 2020.

VALUATION SUMMARY
PERIOD ENDING 30 SEPTEMBER 2020

Manager / Fund	30 June 2020 Valuation £000s	30 June 2020 Weight %	Cashflow £000s	Growth £000s	30 September 2020 Valuation £000s	30 September 2020 Weight %
UBS Passive Equity	55,425	7.1	-5,000	1,752	52,177	6.4
UBS Alternative Beta	76,531	9.8	-	752	77,283	9.5
LCIV RBC Sustainable Equity Fund	87,704	11.2	-	5,396	93,101	11.4
LCIV Global Alpha Growth Fund	89,767	11.4	-	6,797	96,564	11.8
BlackRock World Low Carbon Equity Tracker Fund	81,031	10.3	-	3,241	84,272	10.3
Global Equities	**390,458**	**49.8**			**403,396**	**49.5**
UBS HALO EM Fund	49,990	6.4	-	2,305	52,295	6.4
LCIV Emerging Market Equity Fund	31,222	4.0	-	2,545	33,767	4.2
Emerging Market Equities	**81,212**	**10.3**			**86,062**	**10.6**
LCIV Global Total Return Fund	34,933	4.4	-	-552	34,381	4.2
LCIV Diversified Growth Fund	32,538	4.1	-	1,092	33,629	4.1
Diversified Growth Fund	**67,471**	**8.6**			**68,011**	**8.3**
UBS Triton Property Unit Trust	16,255	2.1	-	-27	16,229	2.0
BlackRock UK Property Fund**	7,403	0.9	-	-	7,403	0.9
Property	**23,658**	**3.0**			**23,632**	**2.9**
MIRA Infrastructure Global Solution II, L.P.*	8,871	1.1	-383	-	8,487	1.0
Quinbrook Low Carbon Power LP*	8,703	1.1	1,262	-	9,965	1.2
JP Morgan Infrastructure Fund***	18,837	2.4	-321	100	18,616	2.3
Infrastructure	**36,410**	**4.6**			**37,067**	**4.5**
Permira Credit Solutions IV*	9,771	1.2	615	-	10,386	1.3
Churchill Middle Market Senior Loan Fund II*	13,066	1.7	340	-	13,406	1.6
Private Credit	**22,838**	**2.9**			**23,792**	**2.9**
Growth Assets	**622,047**	**79.2**			**641,961**	**78.7**
Wells Fargo – RMF	91,386	11.6	-	6,325	97,711	12.0
Bonds	**91,386**	**11.6**			**97,711**	**12.0**
LCIV MAC Fund	67,362	8.6	-	2,290	69,652	8.6
Multi Asset Credit	**67,362**	**8.6**			**69,652**	**8.6**
Stabilising Assets	**158,747**	**20.2**			**167,362**	**20.5**
Cash	4,555	0.6	1,625	-	6,180	0.8
TOTAL MERTON PENSION FUND	**785,350**	**100.0**	**-1,862**	**32,015**	**815,503**	**100.0**

2.2 The Fund's total market value increased by £30.1m over the quarter, from £785.4m to £815.5m. the increase in asset value increase in global equity , emerging market equity and the bond investment manly contributed to the increase in value.The other assets classes remind stable over the quarter.

2.2 Over the 3 months to 30 September 2020, total Fund assets returned 3.8% compared to the target of 1.2%. This equates to outperformance by 2.6%. Over the last 12 months, the Fund performance was 5.3%, and 3 year annualised performance was 6.8%. The annual performance target is 4.8%. The table below shows the total fund valuation and the movements in investments during the respective quarter.

PERFORMANCE SUMMARY
1 JULY 2020 TO 30 SEPTEMBER 2020

Manager / Fund	3 Months %		12 Months %		3 Years % p.a.	
	Fund	B'mark	Fund	B'mark	Fund	B'mark
UBS Passive Equity Fund*	1.0	n/a	0.0	n/a	5.6	n/a
UBS Alternative Beta	1.0	1.0	-0.9	-1.3	n/a	n/a
LCIV RBC Sustainable Equity Fund	6.2	3.2	14.8	5.2	n/a	n/a
LCIV Global Alpha Growth Fund	7.6	3.8	25.5	5.7	n/a	n/a
BlackRock World Low Carbon Equity Tracker	4.0	4.0	6.5	6.2	n/a	n/a
Global Equities						
UBS HALO EM Fund	4.2	4.7	9.5	5.3	n/a	n/a
LCIV Emerging Market Equity Fund	8.2	4.7	13.6	7.2	n/a	n/a
Emerging Market Equities						
LCIV Global Total Return Fund	-1.6	1.8	0.2	4.9	n/a	n/a
LCIV Diversified Growth Fund	3.4	0.9	-1.1	3.9	n/a	n/a
*Mercer Universe Median****		*2.4*		*0.2*		
*Mercer Universe Upper Quartile****		*3.1*		*3.0*		
Diversified Growth Fund						
UBS Triton Property Unit Trust	0.7	0.2	-1.9	-2.8	3.9	2.6
BlackRock UK Property Fund**	-1.2	-2.0	-2.8	-2.6	3.3	3.4
Property						
MIRA Infrastructure Global Solution II, L.P.**	4.3	1.8	6.0	7.3	n/a	n/a
Quinbrook Low Carbon Power LP**	19.4	1.8	17.5	7.3	n/a	n/a
JP Morgan Infrastructure Fund	0.5	2.4	n/a	n/a	n/a	n/a
Infrastructure						
Permira Credit Solutions IV**	3.1	1.7	16.1	7.0	n/a	n/a
Churchill Middle Market Senior Loan Fund II**	5.1	1.7	3.7	7.0	n/a	n/a
Private Credit						
Growth Assets						
Wells Fargo - RMF	6.9	6.9	n/a	n/a	n/a	n/a
Bonds						
LCIV MAC Fund	3.3	1.0	-2.0	4.7	n/a	n/a
*Mercer Universe Median*****		*2.6*		*0.9*		
*Mercer Universe Upper Quartile*****		*3.3*		*3.9*		
Stabilising Assets						
TOTAL MERTON PENSION FUND	**3.8**		**5.3**		**6.8**	

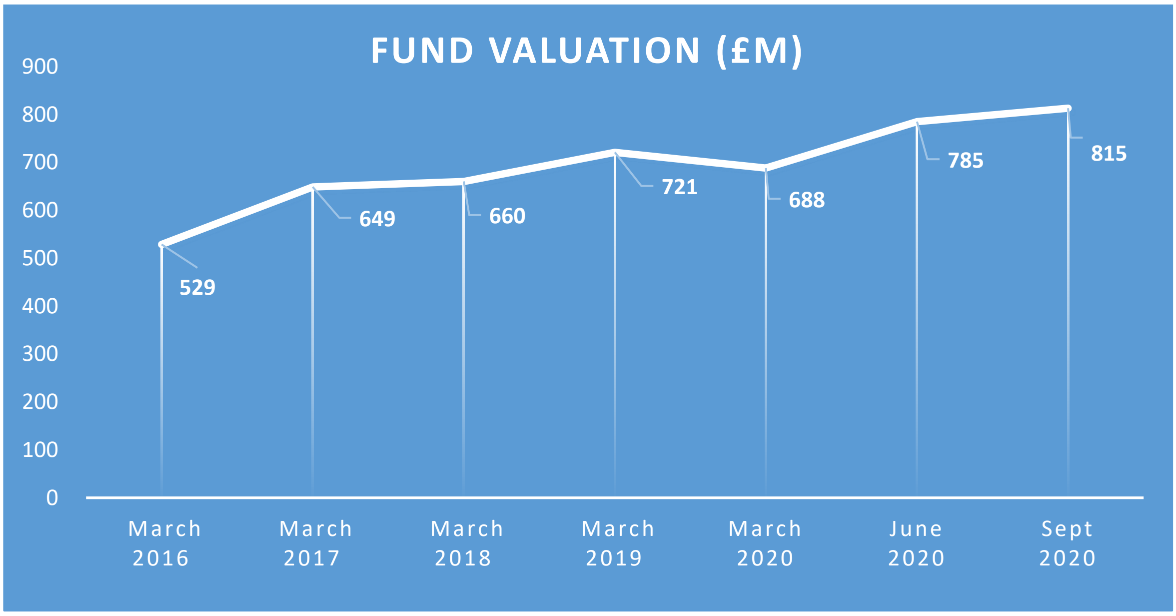
Strategic Target	(4.8% p.a.)	1.2	4.8	4.8

2.3 The Fund is an open fund and long-term investment focused. The Fund will continue work on this basis with the key focus to ESG and maintain a stable contribution rate.

STRATEGIC ASSET ALLOCATION 30 SEPTEMBER 2020

Asset Class	Market Value £000s	Actual Weight %	Strategic Allocation %	Relative Allocation %	Strategic Range %
Global Equities	403,396	49.5	40.0	9.5	15-85
Emerging Market Equities	86,062	10.6	10.0	0.6	0-20
Diversified Growth Fund	68,011	8.3	10.0	-1.7	0-20
Property	23,632	2.9	5.0	-2.1	0-10
Private Credit	23,274	2.9	7.5	-4.6	0-10
Infrastructure	37,067	4.5	7.5	-3.0	0-15
Bonds	97,711	12.0	10.0	2.0	0-30
Multi Asset Credit	69,652	8.5	10.0	-1.5	0-20
Cash	6,180	0.8	0.0	0.8	-
TOTAL MERTON PENSION FUND	**815,503**	**100.0**	**100.0**	**-**	

2.4 The following graph illustrates the Fund's market value trend over the past 5 ½ years and as at 30 September 2020. It shows that in this period the Fund value has appreciated by £286m or 35%.



3.0 Market Background/Outlook

3.1 Since the peak of the COVID-19 pandemic in the Spring, the market narrative has been dominated by the transition to a "new normal", driven by the forces of technological disruption, deficit spending, and further central bank action. Those forces continued to drive equity markets higher in Q3 2020, although the quarter comprised two distinct parts.

3.2 The first was a rally to record highs which peaked at the start of September. The second was a pullback from the peak, accompanied by a rotation out of mega-cap tech stocks. At its peak, the tech-heavy Nasdaq had rallied 76% from the March lows, and had risen 20% since the start of the quarter.

3.3 Given the weight of the mega-cap tech names in the S&P 500, the index rallied by 60% from the March trough to the September peak, with a 16% gain in the first two months of Q3 2020. For markets to move materially higher investors perhaps want to see a move from "new normal" to "more normal". In particular, investors want to see a path toward sustainable mobility gains (enabled by vaccine developments) and a reduction in US political uncertainty. Timing is uncertain and progress uneven, the end result is volatility, which we expect will continue.

4. OTHER ISSUES AFFECTING THE FUND

4.1 None

5. FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

5.1 All relevant implications are included in the report.

6. LEGAL AND STATUTORY IMPLICATIONS

6.1 All relevant implications are included in the report.

7. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

7.1 N/A

8. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

8.1 Risk management is an integral part of designing the investment portfolio of the fund.

9. BACKGROUND PAPERS

9.1 Mercer Investment Consultants performance report.

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MERCER

MERTON PENSION FUND
INVESTMENT PERFORMANCE REVIEW
QUARTER ENDING 30 SEPTEMBER 2020

SHORT REPORT

MARSH & McLENNAN COMPANIES

STRATEGIC ASSET ALLOCATION
30 SEPTEMBER 2020

Allocation by underlying asset class

Asset Class		Market Value £000s	Actual Weight %	Strategic Allocation %	Relative Allocation %	Strategic Range %
Global Equities		403,396	49.5	40.0	9.5	15-85
Emerging Market Equities		86,062	10.6	10.0	0.6	0-20
Diversified Growth Fund		68,011	8.3	10.0	-1.7	0-20
Property		23,632	2.9	5.0	-2.1	0-10
Private Credit		23,274	2.9	7.5	-4.6	0-10
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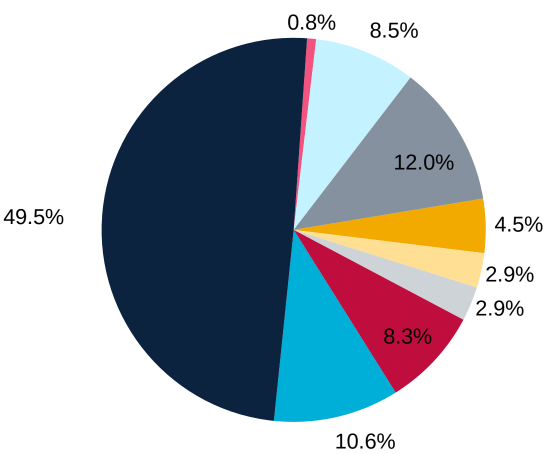
Multi Asset Credit		69,652	8.5	10.0	-1.5	0-20
Cash		6,180	0.8	0.0	0.8	-
TOTAL MERTON PENSION FUND		**815,503**	**100.0**	**100.0**	**-**	

Points to note

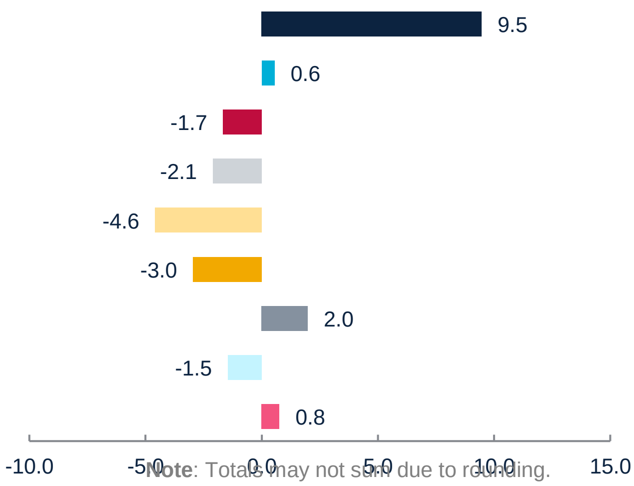
- The Strategic Asset Allocation (SAA) reflects the strategy to be implemented as part of the 2017 Investment Strategy Review; as such, a number of asset classes, in particular the less liquid ones such as private credit and infrastructure, will be underweight for an interim period until the portfolio is fully constructed. The SAA is currently being updated to reflect the recommendations of the 2020 Investment Strategy Review.

- Total allocation to Global Equities decreased by 0.3% to 49.5% over the quarter, being 9.5% overweight relative to its strategic allocation. This allocation will fall over time as the Fund transitions the remaining c.£52.2m from UBS Passive Equity to Private Credit and Infrastructure.

Actual Asset Allocation as at 30 September 2020 (%)



Deviation from Strategic Allocation



Note: Totals may not sum due to rounding.

VALUATION SUMMARY
30 JUNE 2020 TO 30 SEPTEMBER 2020

Manager / Fund	30 June 2020 Valuation £000s	30 June 2020 Weight %	Cashflow £000s	Growth £000s	30 September 2020 Valuation £000s	30 September 2020 Weight %
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UBS Alternative Beta	76,531	9.8	-	752	77,283	9.5
LCIV RBC Sustainable Equity Fund	87,704	11.2	-	5,396	93,101	11.4
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Growth Assets	**622,047**	**79.2**			**641,961**	**78.7**
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Bonds	**91,386**	**11.6**			**97,711**	**12.0**
LCIV MAC Fund	67,362	8.6	-	2,290	69,652	8.6
Multi Asset Credit	**67,362**	**8.6**			**69,652**	**8.6**
Stabilising Assets	**158,747**	**20.2**			**167,362**	**20.5**
Cash	4,555	0.6	1,625	-	6,180	0.8
TOTAL MERTON PENSION FUND	**785,350**	**100.0**	**-1,862**	**32,015**	**815,503**	**100.0**

NOTE: ESTIMATED INCOME REINVESTED BY LCIV FUNDS IN THE QUARTER AMOUNTED TO c. £0.47m.
* Valuation as at 30/09/20 is based on the 30/06/20 valuation plus cashflows in Q3 2020. Valuation for 30/09/2020 was not available at the time of writing this report.
**Valuation as at 30/06/20 is used since the valuation as at 30/09/2020 was unavailable at the time of writing this report.
*** Valuation as at 30/09/2020 and cashflows across the quarter are estimated by JP Morgan.

PERFORMANCE SUMMARY
PERIOD ENDING 30 SEPTEMBER 2020

Manager / Fund	3 Months %		12 Months %		3 Years % p.a.	
	Fund	B'mark	Fund	B'mark	Fund	B'mark
UBS Passive Equity Fund*	1.0	n/a	0.0	n/a	5.6	n/a
UBS Alternative Beta	1.0	1.0	-0.9	-1.3	n/a	n/a
LCIV RBC Sustainable Equity Fund	6.2	3.2	14.8	5.2	n/a	n/a
LCIV Global Alpha Growth Fund	7.6	3.8	25.5	5.7	n/a	n/a
BlackRock World Low Carbon Equity Tracker Fund	4.0	4.0	6.5	6.2	n/a	n/a
Global Equities						
UBS HALO EM Fund	4.2	4.7	9.5	5.3	n/a	n/a
LCIV Emerging Market Equity Fund	8.2	4.7	13.6	7.2	n/a	n/a
Emerging Market Equities						
LCIV Global Total Return Fund	-1.6	1.8	0.2	4.9	n/a	n/a
LCIV Diversified Growth Fund	3.4	0.9	-1.1	3.9	n/a	n/a
*Mercer Universe Median****		*2.4*		*0.2*		
*Mercer Universe Upper Quartile****		*3.1*		*3.0*		
Diversified Growth Fund						
UBS Triton Property Unit Trust	0.7	0.2	-1.9	-2.8	3.9	2.6
BlackRock UK Property Fund**	-1.2	-2.0	-2.8	-2.6	3.3	3.4
Property						
MIRA Infrastructure Global Solution II, L.P.**	4.3	1.8	6.0	7.3	n/a	n/a
Quinbrook Low Carbon Power LP**	19.4	1.8	17.5	7.3	n/a	n/a
JP Morgan Infrastructure Fund	0.5	2.4	n/a	n/a	n/a	n/a
Infrastructure						
Permira Credit Solutions IV**	3.1	1.7	16.1	7.0	n/a	n/a
Churchill Middle Market Senior Loan Fund II**	5.1	1.7	3.7	7.0	n/a	n/a
Private Credit						
Growth Assets						
Wells Fargo - RMF	6.9	6.9	n/a	n/a	n/a	n/a
Bonds						
LCIV MAC Fund	3.3	1.0	-2.0	4.7	n/a	n/a
*Mercer Universe Median*****		*2.6*		*0.9*		
*Mercer Universe Upper Quartile*****		*3.3*		*3.9*		
Multi-Asset Credit						
Stabilising Assets						

TOTAL MERTON PENSION FUND	**3.8**	**5.3**	**6.8**
Strategic Target (4.8% p.a.)	**1.2**	**4.8**	**4.8**

Returns for private market managers are approximate, and may be low initially due to the J-curve effect. Private market investment performance is calculated on an IRR basis. All other manager performance is calculated using time-weighted rate of return.
* Benchmark suspended in Q2 2018 as a result of transition activity. This impacts 3 year benchmark returns
** Performance shown to Q2 2020 due to Q3 2020 data unavailability at the time of writing.
*** Based on the net returns of 48 international Diversified Growth Funds researched by Mercer.
**** Based on the net returns of 16 Multi-Asset Credit Funds researched by Mercer.

MARKET BACKGROUND
PERIOD ENDING 30 SEPTEMBER 2020

MARKET STATISTICS

Market Returns Growth Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	-2.9	-16.6	-3.2
Overseas Developed	3.3	5.8	9.4
North America	4.5	10.5	13.6
Europe (ex UK)	1.6	0.7	3.1
Japan	2.4	2.6	5.4
Asia Pacific (ex Japan)	0.8	-3.0	2.3
Emerging Markets	4.5	4.6	4.6
Frontier Markets	4.3	-16.0	-7.7
Hedge Funds**	3.4	2.4	2.7
Commodities**	4.0	-29.7	-11.5
High Yield**	3.8	1.3	2.4
Emerging Market Debt	-3.8	-6.1	1.4
Senior Secured Loans**	3.3	0.4	1.7
Cash	0.0	0.7	0.7

Market Returns Bond Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Gilts (>15 yrs)	-2.5	5.2	9.5
Index-Linked Gilts (>5 yrs)	-2.5	0.4	7.0
Corporate Bonds (>15 yrs AA)	-1.0	6.7	8.7
Non-Gilts (>15 yrs)	0.5	6.2	7.9

Exchange Rates: Change in Sterling	3 Mths %	1 Year %	3 Years % p.a.
Against US Dollar	4.6	4.9	-1.2
Against Euro	0.2	-2.5	-1.0
Against Yen	2.3	2.4	-3.3

Inflation Indices	3 Mths %	1 Year %	3 Years % p.a.
Price Inflation – RPI	0.5	1.1	2.3
Price Inflation – CPI	0.4	0.5	1.6
Earnings Inflation*	2.8	1.7	2.9

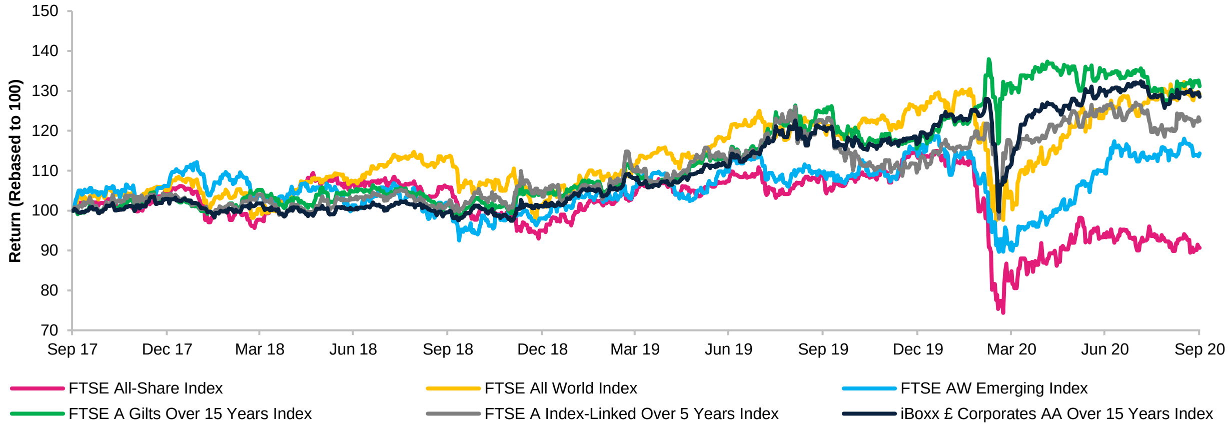
Yields as at 30 September 2020	% p.a.
UK Equities	4.56
UK Gilts (>15 yrs)	0.71
Real Yield (>5 yrs ILG)	-2.29
Corporate Bonds (>15 yrs AA)	1.53
Non-Gilts (>15 yrs)	2.08

Absolute Change in Yields	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	-0.10	0.35	0.88
UK Gilts (>15 yrs)	0.13	-0.20	-1.13
Real Yield (>5 yrs ILG)	0.09	-0.09	-0.78
Corporate Bonds (>15 yrs AA)	0.08	-0.28	-1.11
Non-Gilts (>15 yrs)	0.01	-0.26	-0.97

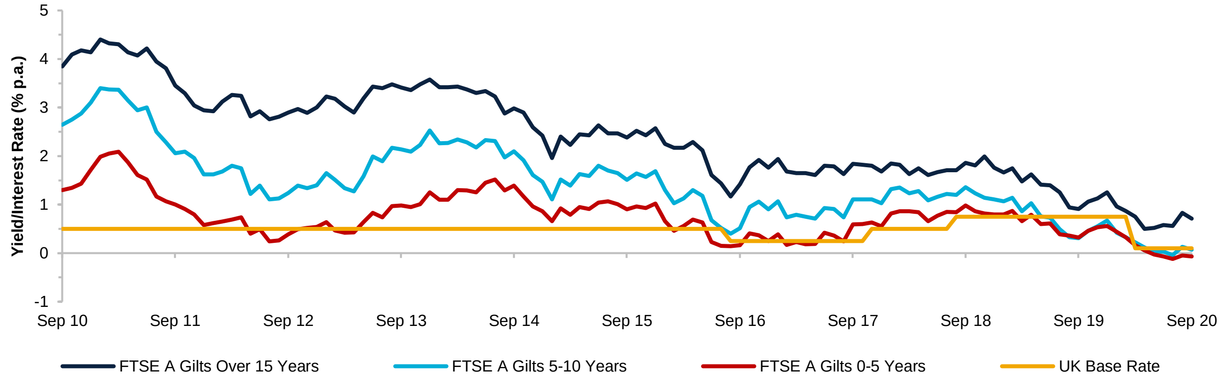
Source: Refinitiv
Note: * Subject to 1 month lag ** Local Currency / GBP Hedged

MARKET SUMMARY CHARTS

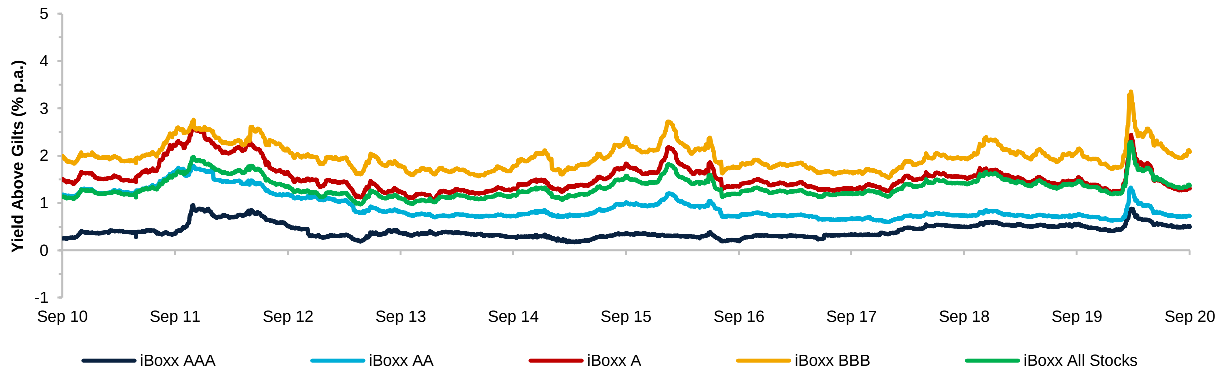
Market performance – 3 years to 30 September 2020



UK government bond yields – 10 years to 30 September 2020



Corporate bond spreads above government bonds – 10 years to 30 September 2020



Source: Refinitiv, Datastream

MARKET EVENTS

What is Happening?		
Asset Class	**Positive Factors**	**Negative Factors**
United Kingdom		• The FTSE 100 was down 4.9% over the quarter. This was due to the re-imposition of restrictions owing to the rise of COVID-19 infections along with renewed concerns about the market impact of Brexit.
North America	• The S&P 500 Index posted positive returns over the quarter, owing to the indications of an economic recovery coupled with accommodative monetary policies.	• Though the S&P 500 Index rose over the quarter, the US economy shrunk at an annualized rate of 31.4% quarter-on-quarter in Q2 2020 owing to the disruptions caused by COVID-19. Furthermore, the uncertainty around the US Presidential elections and concerns over the lack of fiscal stimulus measures are likely to affect market sentiment in the near term.
Europe (ex UK)		• The FTSE Developed Europe (ex UK) Index remained flat over the quarter due to contracting business activities as localised restrictions were imposed in many European countries due to sharply rising COVID-19 infections. Additionally, the near term outlook for European equities remains uncertain due to deflationary pressures coupled with the strengthening of the Euro.
Japan	• Despite a rise in COVID-19 cases globally, Japanese equities performed positively over the quarter. The TOPIX returned 11.7% in GBP terms.	• Though the TOPIX posted positive returns over Q3 2020, the resignation of Shinzo Abe in August led to a momentary sense of uncertainty in the Japanese markets, over fear of discontinuation of his signature monetary and fiscal policies.
Asia Pacific (ex Japan)	• The FTSE Asia Pacific ex Japan Index posted a positive return as Asian Markets stabilised on the belief that demand will bounce back in the first half of 2021.	• Despite the rise over the quarter, high uncertainty around economic growth and the inflation outlook are likely to fuel market volatility in near future.

	What is Happening?	
Asset Class	**Positive Factors**	**Negative Factors**
Emerging Markets	• Emerging Market (EM) equities rose over Q3 2020 (The FTSE EM Index posted positive 4.5% returns in Sterling terms) due to the reopening of major emerging economies, increased capital inflows and lower global interest rates. Additionally, a weaker US dollar proved beneficial.	• Emerging markets outside East Asia remain the epicenter of the disease, which is hampering economic activity, especially in India and Latin America.
Conventional Gilts	• The UK yield curve shifted up marginally over the quarter, reflecting the general risk-on sentiment. UK monetary policy was unchanged but on the fiscal side, another spending package was announced over the quarter.	• Emerging Market (EM) equities rose over Q3 2020 (The FTSE EM Index posted positive 4.5% returns in Sterling terms) due to the reopening of major emerging economies, increased capital inflows and lower global interest rates. Additionally, a weaker US dollar proved beneficial.
Index-Linked Gilts	• UK index linked yields increased less than UK nominal yields due to a slight pick up in longer term inflation expectations.	
Corporate Bonds	• Despite the rise in COVID-19 cases, UK corporate bonds generated a positive return owing to strong institutional demand and liquidity from central banks.	
Commodities	• The Bloomberg Commodity Index rose over the quarter. Livestock and Agricultural commodities were the best performing components. Industrial metals, led by coal, iron ore and zinc, showed good gains as a strong recovery in manufacturing drove demand for industrial metals.	• Energy was the only component that produced negative returns amid concerns about the sustainability of the recovery in global growth.
UK Property	• The IHS Markit / CIPS UK Construction Purchasing Managers ' Index rose to 56.8 in Q3 2020, affirming a reacceleration in the pace of activity growth. This was driven by home building activity and work on commercial projects.	• Many property funds have been suspended for the entire quarter as clauses of "material uncertainty" made it impossible to value the underlying holdings accurately. This not only makes it impossible to continue with sale and purchasing transactions, but also induces uncertainty surrounding the transparency of prices and rent collection, which further strains the property market.

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- The valuation of investments in property based portfolios, including forestry, is generally a matter of a valuer's opinion, rather than fact.
- When there is no (or limited) recognised or secondary market, for example, but not limited to property, hedge funds and other derivative based funds or portfolios it may be difficult for you to obtain reliable information about the value of the investments or deal in the investments.
- Where the investment is via a fund of funds the investment manager typically has to rely on the underlying managers for valuations of the interests in their funds.

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London Borough of Merton Pension Fund

Actuarial update

Barry McKay FFA
Partner, Barnett Waddingham

November 2020

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What's on the agenda?

2019 valuation…

Where did we get to?

…to now.

What has happened since the 2019 valuation?

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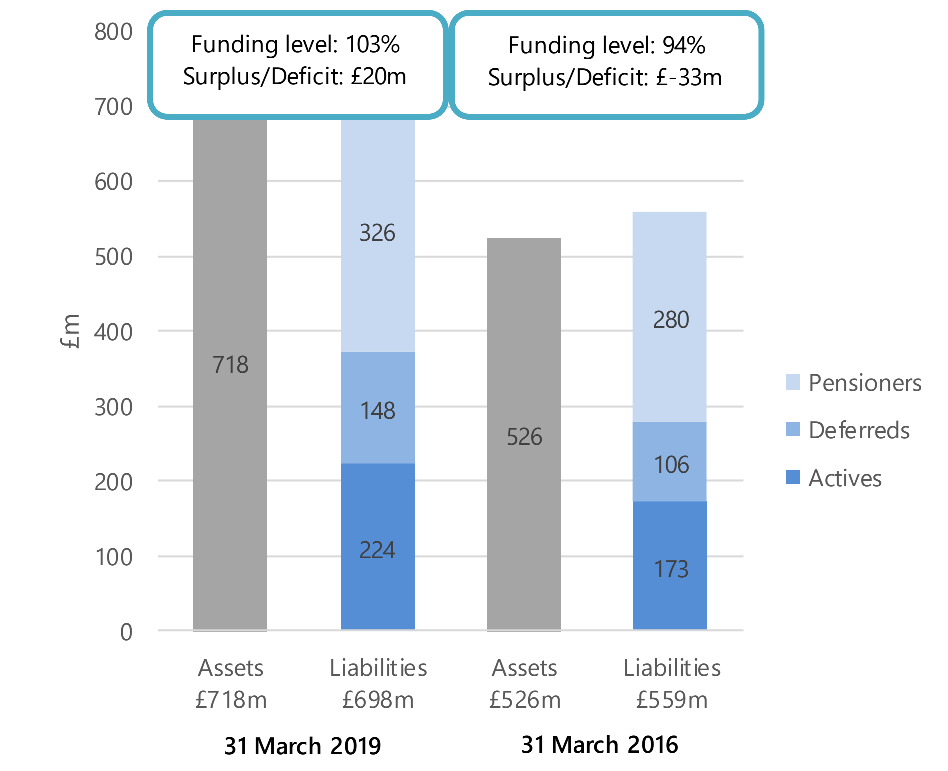
2019 Valuation results



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What has happened since March 2019?

...a lot!

- COVID-19 Crisis
  - Market falls and volatility
  - Mortality experience
- Regulatory activity
  - McCloud
  - £95k exit cap
  - Employer flexibilities

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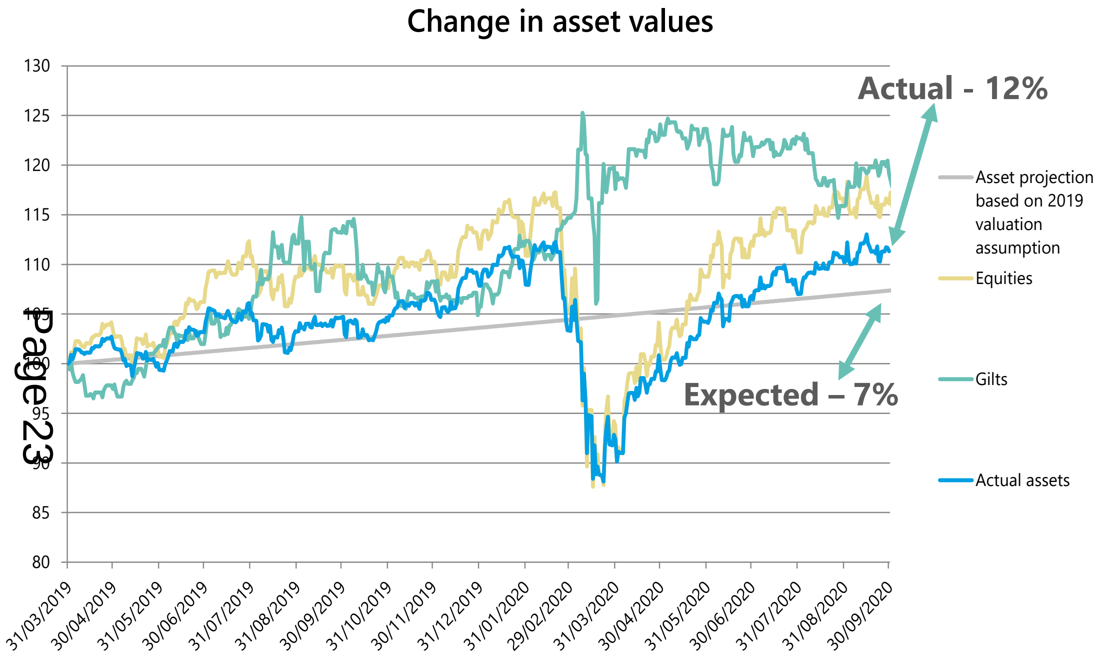
Market volatility

Funding update



- **Returns have been strong but volatile – increase in assets**
- **Lower future returns expected 0.6% p.a. – increase in liabilities**
- **Lower inflation expected of around 0.3% p.a. – decrease in liabilities**

Funding level is broadly unchanged since 31 March 2019

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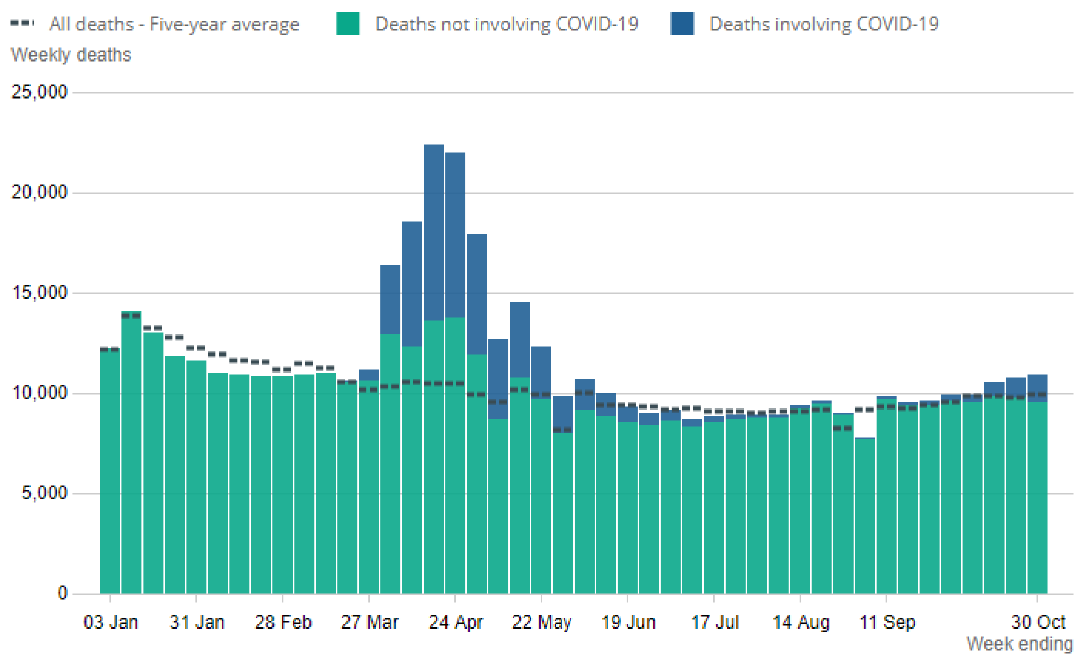
Mortality - Excess deaths



Source: Office for National Statistics

Over 55,000 more deaths than expected in the UK in 2020 (year to date), an increase of around 12%

Around 85% of excess deaths directly attributable to covid-19. Unexplained deaths could include:

- Deaths where Covid-19 was involved, but was not included on the death certificate;
- Deaths indirectly related to the pandemic. For example, increased pressure on health services, cancellation of hospital treatments or fewer people going to Accident and Emergency.

Recent flurry of consultation activity

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McCloud consultation published

Response to £95k cap consultation

Employer flexibilities

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McCloud

Background

- Two consultations issued (LGPS / unfunded schemes)
- Remedy proposed extends to all members active on 31/3/2012
- Underpin to apply from 1 April 2014 to 31 March 2022
- Higher of pension accrued under CARE and FS scheme

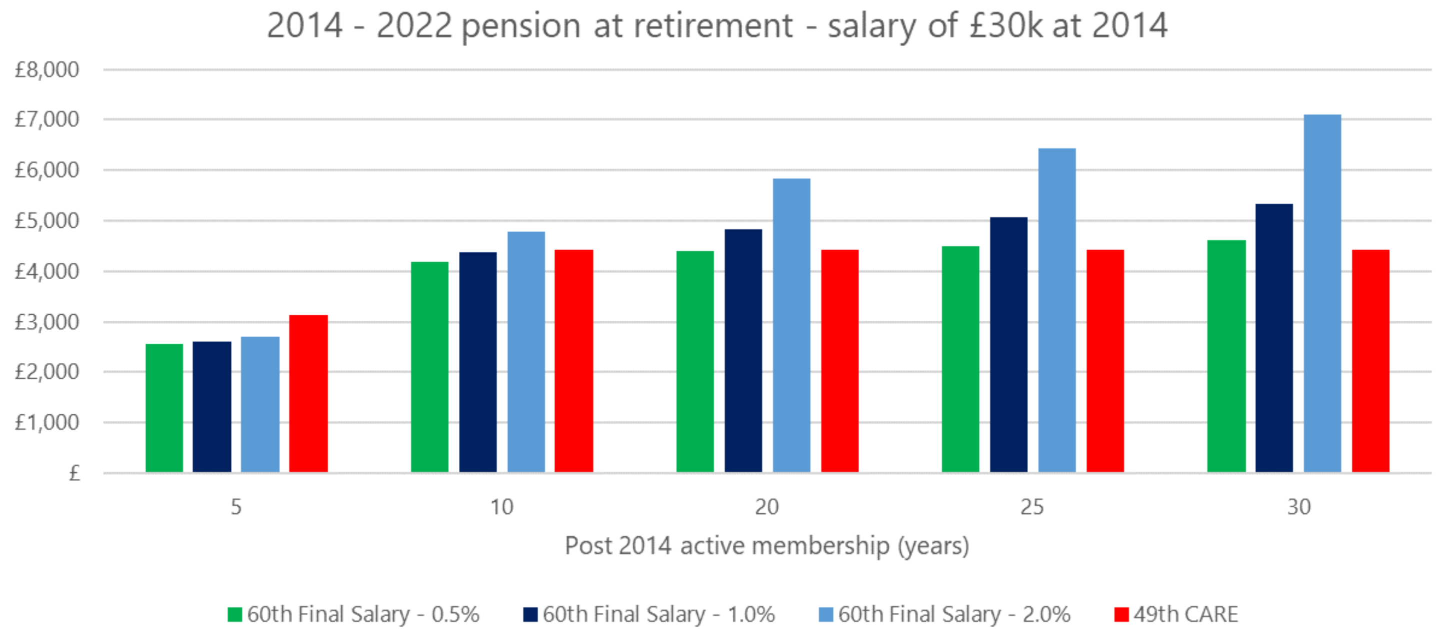
Funding

- £2.5bn estimated impact in LGPS (GAD estimate)
- Lower on the Fund's pay growth assumption
- Contributions may increase by around 0.5% - 0.7% of pay
- May be more material for some employers

Administration

- Administration issues are significant
- Review of member records back to 1 April 2014
- Historic data collection required and problematic
- Communications with members

Pension projections in 2020 terms - pre 2012 joiner



Greater benefit of underpin for younger members
Ignores different retirement ages for final salary benefits and CARE benefits

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The £95k exit cap

Background

- Objective – to avoid six figure redundancy package
- Pension strain cost included in cap
- Predominantly council/academies affected

Impact

- More members impacted, not only high earners
- Not just those with a package > £95k (GAD – 86%)
- Statutory redundancy/discretionary pay also taken into account

Administration

- Timing issue between LGPS / HMT Regs
- Communicating options to members

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Member options – strain cost greater than £95k

	Existing provisions - no reduction and no £95k cap	No reduction but pays cash top up	Partial reduction in exchange for statutory pay	Full reduction	Defers to normal retirement age with no reduction
Retirement benefits taken	Immediately	Immediately	Immediately	Immediately	Normal retirement age
Pension	£19,821	£19,821	£18,501	£12,990	£19,821 plus revaluation
3/80ths lump sum	£15,752	£15,752	£15,707	£13,987	£15,752 plus revaluation
Statutory redundancy pay	£14,795	£0	£0	£14,795	£14,795
Discretionary compensation	£19,727	£0	£0	£19,727	£19,727
Standardised strain cost	£124,671	£95,000	£95,000	£0	£0
Payment from member	n/a	£29,671	£0	n/a	n/a
Total value of exit package	£159,194	£95,000	£95,000	£34,522	£34,522
Difference vs existing provisions	n/a	£64,194	£64,194	£124,671	£124,671

Member age 56 at retirement, pay of £60k and 20 years service

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Employer flexibilities

Contribution reviews

Significant changes during inter-valuation period

Ability to review if change in liabilities / covenant

Exit payments

Too expensive to stay, too expensive to go

Spreading of exit payments

Deferred debt arrangements

Unaffordable cessation debt

Continued participation without triggering a debt

Risk remains with employer, revised valuation

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Considerations for funds

- Consider approach to be taken
  - Key factors triggering a review / spreading exit / allowing DDA
  - Impact on other employers
  - Monitoring
  - Timing and costs – when, how often, who meets costs
- Revise FSS
- Communicating to employers
- Review any existing arrangements/admission agreements

THANK YOU

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London Borough of Merton Pension Fund

Report to Pension Committee - Update on consultations impacting the LGPS

We have been asked by the London Borough of Merton, the administering authority for the London Borough of Merton Pension Fund (the Fund), to provide a report setting out updates and progress in relation to the various consultations that could affect the Fund.

This report provides the background to each consultation, the issues and potential impacts to stakeholders and any actions the Fund can and should be considering. The impacts on stakeholders are often wide ranging and varied so this report cannot provide specific advice but its purpose is to consider these impacts at Fund level.

The McCloud Judgement

Background

Based on the recommendations of the Hutton report, all public sector pension schemes were reformed in 2015 and benefits were changed going forwards. As part of this reform, transitional provisions were given to members, who in 2012 were within 10 years of their normal retirement age. The laudable aim was to ensure that any changes would not impact those members closest to retirement.

However, on 20 December 2018, these protections were deemed to be unlawful on the grounds of age discrimination. After a legal battle that saw firefighters and judges joining forces to claim discrimination on the grounds of age, Ms Sargeant and her peers were granted their claim by the Court of Appeal in 2018. In June 2019, the Supreme Court refused the government's application to appeal the court case, by then known as McCloud, which marked the end of the legal process.

The case through the Courts identified unjustified age discrimination in transitional protection arrangements in the Judicial and Firefighters' Pension Schemes. However, in relation to the LGPS, this difference in treatment exists between two groups of LGPS members:

- those who were in service on 31st March 2012 and were within ten years of NPA on 1st April 2012, therefore benefiting from underpin protection and potentially 'better off' than the second group; and,
- those who were in service on 31st March 2012 and were more than ten years from NPA, were not eligible for underpin protection and therefore potentially 'worse off' than the protected members (as they were not guaranteed a pension of at least the level they would have received in the final salary scheme).

Although the judgements are not about the **Local Government Pension Scheme** (LGPS), as rulings in public sector schemes, a remedy will need to be made across all public sector schemes. On 16 July 2020, HMT published a consultation on proposed remedies for the LGPS to remove the age discrimination. The consultation closed on 8 October 2020.

The Consultation

The consultation sets out how MHCLG propose to amend the statutory underpin to reflect the Courts' findings in the McCloud and Sargeant cases. Primarily, the proposals are to remove the age requirements from the underpin qualification criteria. However, there are additional proposals to ensure that the underpin works effectively and consistently for all qualifying members following the extension of the underpin to younger members.

The remedy proposes that the transitional underpin protections will extend to all members active on 31 March 2012 and who have accrued benefits since 1 April 2014 in the career average (CARE) scheme and also amends how the underpin works.

The underpin period will apply from 1 April 2014 to 31 March 2022 and ceases on reaching the 2008 Scheme normal pension age, retirement, leaving or death in service, if earlier.

Members will get the higher amount of pension accrued under either the 2014 Scheme (CARE) or that would have been accrued under the 2008 Scheme (final salary) in the underpin period while retaining the final salary link into the future

From April 2022, it is proposed that the period of underpin protection will cease and all active LGPS members will accrue benefits in the career average scheme, without a continuing final salary underpin.

The underpin will be checked at the underpin date (on leaving reaching NPA or death) and at the underpin crystallisation date, when the member takes their benefits. This will take into account any early/late retirement adjustments.

Impact on members

Analysis shows that on average members will see a small increase in benefits, however this will not be evenly spread. Younger members are likely to benefit more from the underpin as they have longer until retirement and the link to their final salary means that salary increases may outstrip the better accrual rate of the 2014 CARE scheme. In general older members are likely to receive higher benefits from the 2014 CARE scheme and so will not benefit from the underpin, but there will be variations by member.

Impact on funding and contributions

The impact of the remedy might be to increase average primary contributions by around 0.2% - 0.3% p.a. of pay and secondary contributions by around the same (with more variability at individual employer level). However, as we have already allowed for McCloud in our 2019 valuation calculations through various mechanisms such as increased prudence in the discount rate or an explicit asset reserve, we do not intend to revisit the 2019 valuation results (but see below on specific employer costs) as our certified contributions will have already anticipated these increases. Any further differences will be captured at the 2022 valuation.

Impact on administration

There is a significant amount of work to do for the administering authority, namely

- Historic data collection
- Updating pension processes and systems
- Retrospective and future underpin calculations and any backdated pension adjustments as appropriate
- Communications with employers and members

It is recommended that the Pension Committee consider resource requirements and plan accordingly.

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Public sector exit payments

Background

The aim of these changes are to avoid members receiving excessive pension and employment benefits on redundancy.

On 7 September 2020, the Ministry of Housing, Communities and Local Government (MHCLG) published a consultation on exit payment reform in the Local Government Pension Scheme (LGPS). The proposals, set out by MHCLG are of immediate relevance to English **Local Government Pension Scheme** (LGPS) funds. The consultation closed on 9 November.

The Consultation – the proposed cap

Under the existing LGPS Regulations members over age 55 are entitled to receive an immediate unreduced pension if they are made redundant. The resulting strain cost of providing this unreduced pension can be significant. It is proposed that the strain cost is included in the value of the total redundancy package, together with statutory redundancy pay and any other discretionary pay and the total cost of the redundancy package should not exceed £95k. If the cap is exceeded the redundancy package must be scaled back.

The problem for administering authorities

On 4 November 2020 the Restriction of Public Sector Exit Payments Regulations 2020, came into force. This does, however, bring into existence a potential conflict between the two sets of regulations – the Exit Cap Regulations and the LGPS Regulations - where both are applicable and where a member over the age of 55 is made redundant. As the LGPS draft Regulations are still under consultation until 18 December 2020, then in the intervening period there will be a simultaneous obligation that:

- Funds must pay out unreduced pension benefits to the member immediately, including that element above the £95k cap, in line with the current LGPS Regulation 30 (7)
- Employers must not fund any element of the strain cost above the £95k cap, in line with the new Exit Cap Regulations

As things stand there is a serious inconsistency between the exit cap regulations that employers have to adhere to, and the LGPS regulations that bind Administering authorities and employers.

What can we do about it?

The LGA has now published guidance in the form of exit cap information for LGPS employers and for administering authorities. The guide for employers goes step by step through employer obligations and decisions under the exit cap regulations now in force. In particular it sets out the risks of making a cash alternative payment at the moment. The guide for administering authorities sets out the decisions which authorities need to make now including a useful step by step guide that will help with liaising with scheme employers.

Administering authorities and employers should take urgent legal advice if they find themselves with any members that will be affected by the cap before the regulatory conflict is resolved. Administering authorities should, without delay, decide on a policy for paying pensions to members affected by the exit payment cap, following the LGA guidance.

How will members be affected?

What is clear from the latest proposals is that more members are likely to be affected by the cap than perhaps originally envisaged.

For example, as the proposals are currently written, even in cases where the total value of the exit package is less than £95k, some members who are made redundant with an early retirement strain cost becoming payable, would still have their pension reduced by an amount based on their statutory redundancy pay. It is also likely that no additional discretionary pay would be permissible.

This appears to go well beyond the Treasury's expectations when they set the ball rolling on these reforms around 5 years ago and will have the politically undesirable effect of penalising low earners. It seems unfair why a member, whose exit package is well below the £95k cap, should be expected to, in effect, give up all of their redundancy pay - particularly when an element of it is statutory.

To tackle some of these issues an element of choice is being introduced for members as follows:

- Immediate partially reduced pension, receives statutory redundancy pay but no discretionary pay
- Immediate full pension but potentially no statutory redundancy or discretionary pay
- Immediate fully reduced pension, receives statutory redundancy and discretionary pay
- Defer pension until normal retirement, receives statutory redundancy and discretionary pay

Key considerations for the Fund

The Fund needs to decide whether to pay the reduced or full pension benefits to a member over age 55 being made redundant. There is no best option for administering authorities only a least worst option. It is likely funds will comply with the exit cap regulations and pay the reduced benefit with a potential increase to members in the future if there is a challenge or change in approach. Any benefit options or illustrations should be caveated appropriately.

Funds also need to decide what actuarial factors to adopt – the fund specific factors or the GAD factors. Previously this only impacted the timing of when employers funded the strain cost. However, now this matters as it could impact on members' benefit amounts.

We have provided the Fund with a modeller to help work through the different member options, employer' costs and impact on members benefits.

Management of employer risk

On 26 August the Government issued a partial response to the "Changes to the Local Valuation Cycle and the Management of Employer Risk" consultation issued in May 2019. This is the second partial response, this time focussing on flexibilities for employers in the LGPS and contributions payable. There are three main areas that have been considered.

Contribution reviews

The Government response suggests that contribution reviews should be available when an employer sees a significant change in liabilities and/or covenant but that an employer can make a request for a review at any time.

The Fund will need to carefully consider when it is appropriate to review an employer's contribution rate in between valuation dates and therefore a clear policy will be needed in the Fund's Funding Strategy Statement. It's important that this is communicated to employers and that they understand this policy to avoid inappropriate requests and also that any costs should be met by the employer.

Exit payments

There was overwhelming support from funds for additional flexibility on paying any exit debt. This will allow employers to spread any exit payments over a period of time, as agreed with and at the discretion of, the administering authority so as not to expose other employers in the Fund to additional risks. It also addresses the issue of the "too expensive to stay in, too expensive to get out" problem that many employers faced. Therefore, having clarity around this will help the Fund manage any employers with exit debts that are unaffordable as a single payment, which may have forced them into insolvency.

Deferred debt arrangements

Deferred debt arrangements will allow employers to continue to participate in the Fund without any active members. These arrangements are already well established in the private sector for multi-employer schemes and responses to this element of the consultation were also strongly in favour. In fact, it has been the cause of debate in the LGPS community as it wasn't clear whether these types of arrangements were possible under the existing Regulations and there are some of these arrangements already in place. They differ to spreading of exit payments as the value of the debt can be revisited with payments adjusted accordingly and so will require more regular monitoring, and their existence would remain subject to the ongoing agreement of the administering authority. This means the employer retains the risk of good or bad experience and so may end up paying more or less than the amount calculated at the date of exit.

At the time of writing, the Scheme Advisory Board has issued draft guidance for administering authorities and employers that is being considered by a working group.

Key considerations for the Fund

The Fund will need to consider the following, for example:

- What approach the fund wants to take to each option by considering the following:
  - When is it more appropriate to adopt a deferred debt arrangement or spreading an exit payment?
  - What situations could trigger a contribution review i.e. closed employer, merger, significant redundancy exercise or outsourcing. What evidence should be provided by the employer
  - The period where a review is possible e.g. is an employer review sensible in a valuation year when this is happening anyway
  - Should there be more detail in the FSS about how covenant is monitored and measured to tie in with trigger events for a contribution review?
  - What approach would be taken to employers who approach the fund for a contribution review as a result of budget restraints?
  - Which employers each policy does/doesn't apply to?
  - How regularly should deferred debt arrangements be reviewed? Does the Fund need a policy or is this on a case by case basis?
- Communicating the policy to employers
- Further training for Committees/Pension Boards
- Review any existing arrangements in place similar to deferred debt arrangements and consider whether any additional documentation needed

- Consider any templates the Fund could use to simplify the process e.g. for deferred debt arrangements

Changes to male survivors benefits (The Goodwin case)

The Goodwin case affects male survivors (of female members) by extending the applicable service for calculation of benefits from 1988 back to 1978. This only impacts survivor benefits coming into payment after 2005. This doesn't affect who is entitled to benefit, it just impacts the amount to be paid to widowers.

Same-sex survivors were originally entitled to survivor benefits taking into account the member's service from April 1988, however retrospective amendments will be made with effect from 5 December 2005 (the date when civil partnerships became possible), such that those survivor benefits now take into account the member's service from 6 April 1978. Following the Goodwin Tribunal, regulatory amendments will now need to be made with effect from the same date to extend that entitlement to male survivors of female members.

No statutory guidance has been issued from MHCLG as the position is not clear on how retrospection of benefits affects the finality of transfers out or trivial commutation. This has a minimal impact on the Fund's liabilities but the administering authority may need to calculate any increase in benefit for these members.

Barry McKay, FFA

Partner

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Agenda Item 8

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