Tyne and Wear Pension Fund

Annex A
PEST Analysis

South Tyneside Council

Strategic Context

PEST Analysis

1. This PEST analysis sets out the main external influences impacting on the Fund, particularly political, economic, social and technical factors.

2. The **Political** factors are set out below:

- Following a review of public service pension schemes, the Local Government Pension Scheme became a Career Average Revalued Earnings (CARE) scheme from April 2014. Whilst this Scheme is now fully embedded, future changes to the Scheme and Regulations cannot be ruled out.

- In 2015/16 the Government undertook a review of the investment of the Scheme's assets and introduced a requirement for the assets to be pooled. The Fund joined with other funds to create an FCA regulated asset management company called Border to Coast Pensions Partnership Ltd. Assets started to transfer into the new company in 2018/19. To date approximately £5 billion of the Fund's £12.9 billion of assets have been transferred to Border to Coast.

- In 2023/24, the Government reiterated its commitment to asset pooling in the LGPS. This was through a consultation which set a number of proposals for the continuation of pooling. This included a stated desire for all LGPS funds to pool all assets by March 2025. A 'comply or explain' regime will be in operation, although expectation will be very much on compliance, increasingly so as time progresses. Further government aspirations in the pooling consultation included LGPS funds having a 10% allocation to private equity and a 5% commitment to levelling up in the UK.

- As part of the asset pooling consultation, the Government has stated a longer-term plan for the pool companies to be of appropriate scale (£200 billion by 2040). If this policy intent were to be pursued, then this would mean a reduction in the number of pool operators. At present, there are eight different pools in England and Wales, but this would need to reduce to around four to achieve the appropriate scale. The position on asset pooling will need to be monitored closely over the coming years.

- Investment in illiquid assets through Border to Coast started in 2019 but it will take around 10-15 years for legacy illiquid assets to mature and the responsibility for all illiquid assets to transfer. It will be important to ensure that the current and any future investment strategy can be implementable under the new investment pooling company that has been created.

- To date, the Government has not forced funds into mergers or joint working arrangements on pension administration, preferring to encourage innovative means for service delivery, including voluntary shared services such as the arrangement we entered into with Northumberland prior to the merger. In the future, the

Government may consider forced mergers and joint working arrangements. The Fund needs to be positioned to respond to this.

- Reorganisation of public services is a continual process which will impact on the membership of the Fund and the Scheme as a whole. Where the regulatory background permits employers to seek new or continuing membership of the Fund, we want to demonstrate that this is an appropriate option for employers and members in order to prevent the active membership from declining. A declining active membership leads to the Fund maturing more quickly, which could require an increase in employers' contributions and a change in the investment strategy. It also affects the cost base for pension administration and for investment management.

- The Government's Freedom and Choice initiative has led to an increase in workload as members request transfers from defined benefit arrangements such as the Local Government Pension Scheme (LGPS) into defined contribution arrangements. We have introduced a process to evaluate applications for transfers and to ensure that only legal transfers take place. Safeguards are also in place to mitigate the risks of pension scam liberation.

- The Government has previously looked to introduce exit payment caps on employees leaving the public sector under non ill-health employer led initiatives. This would have made redundancy payments less attractive in certain cases, as it would reduce the benefits a leaver may be entitled to. This could then impact on future restructuring by employers. Whilst legislation was initially passed to introduce these exit payment caps, this was later revoked. Nevertheless, it remains policy intent for the Government to take measures in respect of high exit payments in the public sector. The Government has stated that it expects to take action 'as soon as possible'. At the time of writing, it is understood that new proposals from Government are still expected.

- The Government has legislated to increase the threshold for the pension annual allowance and to remove the lifetime allowance. This should alleviate the tax burden on a number of members and this may help in securing continued LGPS membership for higher earners. The Government has removed a long-standing anomaly in the timing mismatch between the CPI rate that is used to revalue accrued benefits in the LGPS and the CPI rate that is allowed for in annual allowance (AA) tax. These changes are welcome in terms of preserving LGPS membership, but it remains to be seen whether any change in Government in 2024 results in the reversal of any of these changes.

- In 2019 a consultation on the valuation cycle was initiated by the Government, with a proposal to move from a three-year valuation cycle to four years. This is to link the cycle into the current four yearly cycle on the unfunded public service schemes. Whilst a move to a four yearly cycle could make sense for financially secure, long-term entities such as councils, this would increase the risks associated with smaller, less financially secure, employers. Whilst very little has been said recently on this

proposal, we need to be able to respond should legislation come forward in the future.

- In September 2022, the Government launched its long-awaited consultation on plans to require LGPS funds to report on climate related risks and opportunities in line with the broad recommendations from the international industry-led Task Force on Climate-Related Financial Disclosures (TCFD). The implementation of the TCFD into the LGPS has been delayed until December 2025, but the Fund is now producing TCFD reports on annual basis in any event. Notwithstanding this, the position will need to be monitored in case any changes are needed to the Fund's approach once reporting becomes mandatory.

- In late November 2022 the Office for National Statistics announced it had reclassified further education colleges from non-profit institutions to the central government sector. This followed the passing of legislation giving the Secretary of State the power to intervene in these organisations under specific circumstances. At this stage it is not clear what impact this reclassification will have on the financial capacity of these organisations to support their LGPS pension obligations. What matters in this context is whether any guarantees will be forthcoming from the Department for Education (DfE) on the debts and liabilities of these organisations – something we understand the DfE is currently considering. The position will continue to be monitored and it may result in the need for the Fund to review its Funding Strategy in respect of colleges. It is not clear to us when the DfE will reach a conclusion on this matter.

- The Government has introduced legislation to provide for Pensions Dashboards that allow individuals to see their pension benefits all in one place. The Fund will be required to participate in this programme and ensure correct member data is available. The staging date for the LGPS has been set for September 2025.

- Following the abolition of contracting-out on 5th April 2016, the Fund is required to reconcile all GMP values held against those held on His Majesty's Revenue and Customs (HMRC). Any difference between the two amounts needs to be rectified and pensions in payments adjusted where necessary.

- In October 2018, the High Court made a landmark judgment confirming that pension schemes are required to equalise male and female members' benefits for the effect of guaranteed minimum pensions (GMPs). We are awaiting guidance from the Government Actuary Department (GAD) as to how GMP equalisation will be applied in the LGPS. The Fund will be required to comply with guidance which may result in the redress of benefit payments and transfer out payments made to members who left the Scheme between 17th May 1990 and 5th April 1997. Further guidance is also awaited in relation to members who transferred in pension rights from a former arrangement and a top up payment has been made by the former Scheme administrator in respect of GMP equalisation.

- The Government has announced that the minimum age at which most pension scheme members can access their pensions benefits without incurring an unauthorised payments tax charge (unless they are retiring due to ill-health), is changing from age 55 to 57 in April 2028. The Local Government Pension Scheme rules will require amendment to comply with this change. A consultation process is yet to commence. When in place, a wide number of actions will be required. These include changes to the Fund's systems and scheme literature and documents and liaison with scheme members and employers.

3. The **Economic** factors are summarised below:

- The Covid-19 pandemic dramatically impacted global economies, companies and individuals. In response to this, Governments, central banks and other policy makers provided significant levels of support to individuals and businesses, reduced interest rates to record levels and increased Quantitative Easing programmes. This ensured good liquidity in financial markets but also contributed to a strong rise in asset values. Nevertheless, many areas of the economy suffered and this has contributed to challenging economic circumstances in subsequent years.

- The record amounts of monetary and fiscal stimulus pumped into economies during the Covid-19 pandemic, combined with elevated levels of cash on household and corporate balance sheets, led to demand outstripping supply and resulted in rising prices and inflation expectations. Additionally, the Russian invasion of Ukraine further increased inflationary pressures around energy prices. Inflation in the UK peaked at around 11%, although this has since fallen back more recently. Higher levels of inflation are a concern for the Fund as it leads to higher pension payments and future liabilities. It can also be negative in the long-term for some of the Fund's investments. The impact of inflationary pressure was reflected in both the funding strategy adopted for the 2022 valuation and the investment strategy. This will need to be kept under review.

- The high levels of inflation in the UK and elsewhere resulted in sustained interest rate increases from central banks. This has stabilised in recent months, but interest rates remain at a high level, certainly in the context of the last 15 years.

- The sharp increase in inflation, as well as impacting on the Fund's assets and liabilities, is also impacting on the finances of the employers and the scheme members. For employers, this is resulting in increased financial pressures which, especially for the contractors in the Fund, could result in a deterioration in their covenant strength and ultimately a financial failure. For scheme members, an increase in the cost of living will squeeze household budgets and may lead to increased numbers opting out of the Scheme. Both of these issues will require monitoring.

- The geo-political and economic situation remains volatile, with rising tensions in the middle east, friction between China and Taiwan / US and the Chinese economy struggling to recover from the Covid pandemic in the way that it had been expected.

As a long-term investor, the Fund is not unduly concerned by shorter term market changes but the economic situation needs to be monitored.

- The 2022 valuation showed an improvement in the funding level from 106% in 2019 to 110% as at 31st March 2022. Most (but not all) of the employers in the Fund are now in surplus and are seeing a small reduction in contribution rates. This will generally be welcomed especially given the current economic environment and the material increase in inflation.

- Since 31 March 2022, investment markets have been extremely volatile, with the Fund value falling from £12.7 billion to £11.9 billion by the end of September 2022, before recovering back to around £12.9 billion in December 2023. The previous fall in asset values was more then offset by a corresponding increase in the discount rates which resulted in a reduction in liability values. This meant the funding level improved despite the fall in asset values.

- The fall in liability values, noted in the previous point, is of particular importance for any employer that may be looking to exit the Fund and the LGPS. These employers will generally have their liabilities valued on a gilts basis on exit. One of the consequences of the recent economic environment is that gilt yields have increased materially since 31st March 2022, which means that any exit valuation is likely to be materially lower than at any period in the recent past, making it potentially an attractive time for employers to exit the Fund. There is evidence at other pension funds of an increase in exit activity and this position will need to be monitored.

- With each employer having different funding levels the funding strategy should be kept under review to respond to issues that may impact on individual employers. Additionally, it remains open to employers to request differential investment strategies and any such requests will be considered on their own merits.

- The UK has left the EU, however the long-term economic impact of this remains uncertain.

- The performance of the Fund over the long-term has been strong. However, the current economic environment, the high volatility in investment markets and concerns over the valuations of some asset classes means that investment performance may be more challenging in coming years. The Fund's diversified investment strategy and decisions around de-risking the strategy, should provide some protection if there is a long-term correction in markets. Nevertheless, the position will need to be monitored.

- Whilst an improvement in the funding level can only be positive for the Fund, this will impact on future cashflows as less money would be collected through employer contributions. This was factored into the review of the investment strategy undertaken in 2019 and 2022, with an increased allocation to income producing assets. Consideration has also been given to ensure the investment products offered by Border to Coast allow for income to be paid to the Fund.

- Many employers that contribute to the Fund operate within tight financial constraints. An increasing number of employers in the private sector have concluded that they will not meet the cost of a defined benefit scheme and have made alternative arrangements. This is an option that may be adopted by our current and potential future admitted bodies if employer contributions are considered to be too expensive. As stated above, declining active membership is a negative factor for the Fund.

- A squeeze on public sector expenditure is expected in coming years to help pay for costs of Covid-19 and the recent energy and cost of living crisis. This may lead to job cuts in the public sector to save money. This coupled with the continued maturity of the Scheme may affect the Fund's cashflow and the type and volume of pension processing that is undertaken. The impact is considered in the funding strategy, the investment strategy and the structure and workload of the Pensions Office.

- The active membership of the Fund may also fall due to members opting out for personal financial reasons, including the current cost of living increases, the continuing real decrease in pensions tax allowances and the increase in the normal retirement age.

- Auto enrolment into the Fund commenced in 2013 with re-enrolment every three years for those who have opted out. This is introducing more active members to the Fund, which is positive.

- The investment strategy is based upon asset liability modelling. Alongside the 2022 valuation an asset liability modelling exercise was undertaken. The improved funding level provided the opportunity for the Fund to de-risk the investment strategy and move out of growth assets, primarily quoted equities, and into more stable, income producing asset. This represents a continued evolution of the strategy adopted in 2019 and earlier years. A health check of the investment strategy was undertaken in 2023/24 and this confirmed that the current strategy remains appropriate. The next full review was take place in 2025, alongside the 2025 valuation.

- The investment arrangements for the Fund are largely contracted out to external investment managers. Whilst the approach to using external management is expected to continue under pooling, it will be Border to Coast who ultimately become responsible for the appointment of managers going forward and not the Fund. The Fund will still need to ensure it has sufficient resources to monitor the performance of Border to Coast and the assets for which they will become responsible.

- Pension administration is undertaken in-house because the Fund has sufficient critical mass and expertise to provide a cost-effective, quality service. The merger with Northumberland County Council Pension Fund has improved our efficiency in

this area. We benchmark the pension administration service against our peers to demonstrate value for money and the quality of the service offered.

- The Fund will continue to explore further options for joint working with other administering authorities in order to deliver further efficiencies.

4. The **Social** factors are set out below:

- We believe that a defined benefit arrangement is the preferred type of pension provision. We want the Local Government Pension Scheme, as provided by the Tyne and Wear Pension Fund, to be regarded by employers and employees as an attractive and affordable part of the employment package.

- Improving longevity has increased the cost of pension provision, although recent evidence suggests there are signs that improving longevity is slowing down. This general slowdown, and the impact of Covid-19, was factored into the 2022 valuation. The position on this will need to be closely monitored going forward.

- Equality, Diversity and Inclusion is important in terms of the service provision, the workforce and governance arrangements. Work is currently underway to establish a base line position for the membership and workforce which will be used to inform future strategies and initiatives. We comply with the Equality Act 2010.

- The Fund is required in its Investment Strategy Statement to set out the extent to which environmental, social and corporate governance (ESG) considerations are taken into account in the selection, retention and realisation of investments. There will be an increased focus on this going forward.

- Climate change is recognised as a material financial risk for the Fund. We will need to ensure that our approach to managing climate-related risks and opportunities is accounted for in the overall investment strategy and by the managers investing the Fund's assets. Ambitious targets have been set for reducing carbon emissions by 30-35% by 2025 and by 50-60% by 2030. In addition, a Net Zero Carbon target date of "2050, or sooner", has been set and a Climate Change Policy agreed. A roadmap of actions to deliver against these targets has recently been agreed by Committee.

- The move to pooling has provided further resources to concentrate on ESG and climate change issues and should strengthen the Fund's approach to responsible investment. Nevertheless, these factors continue to grow in importance, and we need to ensure that we have sufficient resources going forward.

- Customer demands and expectations are changing and there is a continuing shift towards the delivery of services in an electronic format and increased automation. The speed of change is also increasing, and it is important that the service can respond to this. At the same time, it is important that those members who are unable to communicate electronically are not excluded from accessing information or services.

- Ways of working and the labour market have changed in recent years making recruitment and retention more challenging. There is a need for greater flexibility.

5. The **Technical** factors are set out below:

- The Covid pandemic had a significant impact on how the Fund operates and has changed some ways we deliver the service. Some of the impacts have been positive and some negative. The Fund will need to respond to these challenges.

- There has been a high level of turnover and vacancies in the Pensions Service in the last two years. This position is not unique to the Pensions Service with many employers in the same situation. The recruitment market has been challenging, although there are signs of improvement in this respect. We need to respond and adapt to the current environment and ensure that the Pensions Service is accessing all potential new staff and is being seen as an attractive place to work.

- One of the positives to result from the response to Covid was the opportunity to move to a more flexible approach to working and improve people's work life balance. This has provided both risks and opportunities and is leading to long-term changes in working practices and arrangements. It is important that the Fund embraces the opportunities that will be presented and, at the same time, minimises the risks. Whilst increased flexibility is being embraced, much of the work undertaken involves large scale processing and this is more efficient when delivered in the office rather than remotely.

- There is a continued and growing threat from cyber security resulting in a need for enhanced business continuity planning.

- The return of employers to business-as-usual following Covid has resulted in a material increase in processing volumes. This has been exacerbated by increased workload resulting from McCloud (further details on McCloud are provided below). When this higher workload is combined with the reduced resources due to turnover and vacancies, it results in an increase in the backlog of outstanding processes. Whilst a backlog has developed, it should be recognised that this is largely in lower priority work and a recovery plan is in place to address this issue.

- A reorganisation of the Pensions Service was completed in 2022. As expected, this caused some disruption and impacted on workload and processes. Whilst the short-term impact has been detrimental, the new structure will bring longer-term benefits in terms of service delivery and efficiencies.

- There is an increased focus on performance management data and increased transparency. This trend is expected to continue.

- The Fund has reconciled each individual member's Guaranteed Minimum Pension (GMP) entitlement record with those held by His Majesty's Revenue and Customs

(HMRC). The next stage is to undertake rectification work and update records for those members where differences have been identified. Work on this process has commenced but this will continue to progress into 2023/24.

- Initiatives from the Scheme Advisory Board, including but not limited to cost transparency, the academy review, a review of third tier employers and the Good Governance Review will need to be monitored and responded to.

- Since 2015/16, the Pensions Regulator has been involved with pension administration and governance. The role of the Pensions Regulator with regard to the Local Government Pension Scheme is ever increasing with a focus on governance, improved record keeping, internal controls and member communications. The Regulator is in the process of reviewing its current codes of practice with the expectation that they will combine the existing 15 codes of practice (including Code of Practice 14, which relates to public service pension schemes) to form a single, shorter modular code. The intention is that this new single code will be quicker to find, use and update, so that trustees and scheme managers of all types of schemes can be more responsive to changes in regulation. The Fund will need to respond to any changes that result from this new code.

- Another area of focus from the Pensions Regulator is on data quality, with each Fund being required to report scores for both common and scheme specific data.

- Oversight of the funding strategy and comparisons with other funds, including the Government Actuaries Department Section 13 review. This may result in a more standard approach to valuations and a move away from local discretion. The outcome of the Section 13 review of the 2019 valuation has been received, but there is nothing of material concern identified in the report. The Section 13 review will again take place in respect of the 2022 Valuation.

- Within the Section 13 review, noted above, is a comment that specific consideration should be given to a consistent approach to be adopted for conversions to academies. The position in this area will need to be monitored and may lead to changes in the Fund's approach.

- Following the 2016 Valuation, it was found that the cost floor had been breached under the Scheme Advisory Board (SAB) cost management process. A number of proposals were made to reduce certain member contribution rates and also to make some improvements to benefits. However, before these proposals could be considered by the Treasury, the court cases of McCloud and Sergeant (collectively referred to as McCloud) put a hold on the cost management process. The McCloud case has now been resolved and a remedy proposed. The cost management process was therefore re-started after taking account of the impact of McCloud. The outcome from the SAB process, after taking account of McCloud, was that they were no longer recommending any contribution rate or benefit structure changes. This outcome was however, being challenged by the Trade Unions, who dispute that the cost of McCloud should be taken into account as a "member cost" and therefore,

included in the cost management process. If the challenge is successful, the 2016 process could be re-opened. The position will need to be monitored.

- Whilst a risk remains that the 2016 cost management process may be re-opened, work is progressing on the 2020 process. Under the terms of the 2020 process, the trigger for changes being proposed has been increased from 2% to 3% of pensionable pay. This reduces the likelihood of future changes to benefits and/or contributions being proposed and should bring greater stability to the review mechanism. At the current time the expectation is that the outcome will be within the control range and will not result in any changes. The position will, however, need to be monitored.

- The McCloud case related to age discrimination in public service schemes and will result in increased costs. In mid-2020 the Government announced its proposals for remedying the age discrimination issues in the Scheme. These changes were implemented into the LGPS from October 2023.

- The importance of technology and automation to the Pension Fund going forward will increase. This will be key to the future service provision and the communication strategy. The Fund's pensions administration software contract was tendered in 2021 and a new seven year contract (with options to extend for a further three years) started on 1st April 2022. This long-term contract provides greater certainty with regards to future developments.

- The Government has introduced legislation to develop a pensions dashboard to allow individuals to be able to see all their pensions savings and benefits in one place. The Fund will need to ensure that it can develop its service to be able to deliver the information required in the necessary format. The staging deadline for public service schemes (including the LGPS) has been delayed until 30 September 2025.

- The General Data Protection Regulations came into force in May 2018. The Fund has responded to the requirements but still needs to monitor compliance going forward.

- Financial reporting and control have become more complex and the volume of work is increasing. CIPFA issued guidance on this, to which the Fund will need to respond.

- There is a continuing increase in the number and complexity of employer admissions.

- In January 2019, the Government launched a consultation on introducing Fair Deal in the LGPS. It has been proposed that the broadly comparable approach should largely be withdrawn and that transferring staff should remain members of the appropriate public service pension scheme post-transfer. This consultation also proposed the concept of a "deemed" employer status for outsourced services and the automatic transfer of assets and liabilities in reorganisations and mergers

without the need for exit payments. At the time of writing, confirmation is still awaited from Government as to whether these proposals are to be implemented into the LGPS.

- The 2016 Investment Regulations introduced new powers for the Secretary of State to make a direction if not satisfied that an administering authority is acting in accordance with guidance. This includes, but is not limited to, progress on pooling of investments.

- The investment of the Fund continues to become more complex due to the increased use of alternative investments. The investment strategy adopted following both the 2019 and 2022 reviews has resulted in an increased use of alternative investments. There may be further moves into alternatives as the investment strategy evolves.

- The Fund is compliant with all six Investment Principles that cover the areas of effective decision making, investment objectives, risk and liabilities, performance assessment, responsible ownership and transparency and reporting. These are collectively known as the Myners Principles. These Principles may become less relevant if or when changes resulting from the Good Governance review are brought forward by Government.

- Under the Markets in Financial Instruments Directive (MIFID II), the Fund has had to opt up from retail status to professional status with all its investment managers, custodian, Border to Coast and advisors.

- The Financial Reporting Council has reviewed the UK Stewardship Code. Whilst the new Code became effective in 2020, organisations have deadlines each year, to produce an annual report on compliance. The new Code sets high expectations of those investing money on behalf of UK savers and pensioners. In particular, the new Code establishes a clear benchmark for stewardship. Organisations wanting to become signatories to the Code will be required to produce an annual Stewardship Report explaining how they have applied the Code. The Fund is stewardship compliant, but submissions are needed each year.

Tyne and Wear
Pension Fund

Westoe Road
South Shields
Tyne and Wear
NE23 2RL