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.

- In 2024/25, the Government set out its vision for the LGPS through the Pensions Investment Review and "LGPS: Fit for the Future" consultation. Proposed changes include the transfer of all assets to the pool by March 2026, delegation of investment implementation and pools to provide investment strategy advice to funds. The consultation also sets a pathway to enhanced governance at both funds and pools and requirements for local investment.

- 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 and more recently with the Teesside Pension Fund. 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 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.

- 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, it is understood that it may have been dropped, however, 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 TCFD into the LGPS has been delayed, but the Fund is producing TCFD reports on an 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.

- 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. On top of this, 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. Although inflationary pressures have eased somewhat, economic volatility remains, and the position 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 the last 12 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 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 have seen a reduction in contribution rates in recent years.

- 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 £13.4 billion in December 2024. 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.

- 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 delegated to Border to Coast. 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 are 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. Further efficiencies are expected through the shared service with the Teesside Pension Fund. 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 40-45% by 2030 and by 65-75% by 2036. 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.

- 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 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) and staff recruitment / retention problems. 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. Additional staffing resource has been committed to this area.

- 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 2025/26.

- The position on the LGPS: Fit for the Future consultation will need to be monitored.

- The Pensions Regulator introduced the General Code in March 2024. The Fund is largely compliant with this but work will continue in working towards full compliance.

- 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.

- The outcome of the Section 13 review of the 2022 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 2025 Valuation.

- 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) is 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.

- 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