



# South Tyneside Council

## Council

Date: 24th October 2019

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## Pension Fund Merger

Report of the Corporate Director Business and Resources

Cabinet Portfolio/Lead Member: Councillor Ed Malcolm, Lead Member  
Resources and Innovation

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### **Purpose of Report**

1. This report asks Council to consider a merger of Tyne and Wear Pension Fund and Northumberland County Council Pension Fund.
2. Council is recommended to
  - Agree to progress with the merger of Tyne and Wear Pension Fund and Northumberland County Council Pension Fund
  - Delegate the final decision on the implementation to the Pensions Committee in consultation with the Leader and Lead Member, Resources and Innovation This will be subject to the satisfactory conclusion of the due diligence process.

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## **Background**

3. In January 2018, South Tyneside Council successfully set up and commenced a pensions administration shared service arrangement between Tyne and Wear Pension Fund (the Fund) and Northumberland County Council Pension Fund (Northumberland). This is operated from the Town Hall in South Shields, using the systems and processes of the Fund.
4. Prior to taking the final decision on establishing the pensions administration shared service arrangement, consideration was also given to progressing with a full merger of the respective funds. This would have involved combining the investment and funding strategies of both funds. This was a larger and more complex project, which would have increased the risks in relation to the successful implementation of the pensions administration shared services initiative.
5. It was decided therefore, initially to only progress with the shared service arrangement. It was noted that the option of merger could be reconsidered once the shared service arrangement had bedded in.
6. The shared service operation has now been in place for around 18 months, consequently it is considered to be an appropriate time to again consider the option of merger.

## **Legal Process for Merger**

7. The proposal under merger would be for all the assets and liabilities of the pension fund maintained by Northumberland County Council to become the assets and liabilities of the pension fund maintained by South Tyneside Council.
8. Northumberland County Council would also be removed as a body required to maintain a Local Government Pension Scheme (LGPS) pension fund. This would require a change in the LGPS Regulations 2013, following a formal public consultation process. We have been advised by Government that the consultation would be strictly limited to the issue of the merger and the transfer of assets and liabilities from Northumberland County Council to South Tyneside Council.
9. The whole process would need to commence with a formal request for merger from both administering authorities, South Tyneside Council and Northumberland County Council. This would set out the background to the merger.

10. There has only been one other merger of LGPS pension funds in the recent past. This involved the London Boroughs of Wandsworth and Richmond in 2016, which was part of a larger amalgamation of services between the two councils. There were no objections raised to this merger.
11. Whilst there has only been one merger to date it is known that an application for merger has been received by MHCLG in respect of the West Midlands Pension Fund and West Midlands Integrated Transport Authority Pension Fund.

### **Decision Making Regarding Merger**

12. The Council has established a Pensions Committee to deal with all matters arising from the Council's function and responsibilities as the administering authority for the Tyne and Wear Pension Fund.
13. The Pensions Committee has received reports on merger at its meetings in June 2019 and September 2019 and confirmed its support for this initiative and for further due diligence to be undertaken.
14. Cabinet also received a report in early October and supported merger.
15. The purpose of this report is to update Council with details of this initiative, to set out the further actions needed to progress with the merger and to seek approval for merger.
16. Whilst Pensions Committee has an extremely wide delegation from Council it is believed that any decision on merger should be taken by Council. This is because merger will result in a widening of the Council's remit as an administering authority with additional responsibility for the assets and liabilities that are currently the responsibility of Northumberland County Council.
17. It is therefore proposed, that Council take the decision to progress with the merger, with the final implementation being delegated to Pensions Committee in consultation with Leader and the Lead Member Resources and Innovation, following the completion of the due diligence process.
18. Northumberland County Council has confirmed it intends to pursue merger, and is seeking final approval to proceed through its own governance procedures. Once again any approval will be subject to the final completion of the due diligence process.

### **Comparison of the two funds**

19. Attached as an Appendix is a comparison of the two pension funds. In broad terms Tyne and Wear is five to six times larger than Northumberland.
20. In terms of funding levels, investment returns and the current approach to funding and investment both funds are broadly similar.

### **Rationale for Merger**

21. The most significant benefit to the Council and the Fund would be to increase resilience in relation to possible future changes and consolidation within the Local Government Pension Scheme (LGPS). This could help protect jobs in the Council and the region.
22. Whilst further changes to the LGPS are not planned at present, this cannot be ruled out and the experience of having been through a merger process could prove to be beneficial in the future if central government seeks consolidation of pension funds. There are also significant efficiencies that can be delivered from the merger.

### **Potential Governance Arrangements**

23. South Tyneside Council has set up a Pensions Committee to control and resolve all matters relating the Fund.
24. The current membership of the Committee consists of
  - 8 elected members from South Tyneside
  - 4 elected members from the other councils within Tyne and Wear. Each Council also nominates one substitute who can attend all meetings, but can only vote in the absence of the main representative
  - 3 other employer representatives in an observer and non voting capacity
  - 3 trades union representatives in an observer and non voting capacity
25. It is anticipated that Northumberland would be treated in the same way as the other councils within Tyne and Wear, with one elected member on the Committee in a voting capacity, and one substitute.
26. With regards to the Local Pensions Board, it may prove necessary to commence a new appointment process. At present the members of

the Tyne and Wear Local Pension Board are nominated as representatives of the employers and members of the Tyne and Wear Fund. Under the terms of the Constitution the members of the Local Pension Board are in place for three years. The next nomination process is not due to take place until the 2021/22 municipal year, which is one year after the proposed merger start date.

### **Timing of Merger**

27. Whilst merger does not have to take place on any particular date, the current position is that 1<sup>st</sup> April 2020 is being targeted. This has two main advantages:

- 2019/20 is a valuation year and it would be very helpful to align the funding strategies prior to new contribution rates coming in from 1<sup>st</sup> April 2020. The next scheduled valuation is not until 2022/23, although this is possibly subject to change by Government.
- During 2019 assets are being moved from the individual funds to Border to Coast, as part of the Government's investment pooling initiative. This presents an opportunity to align the fund's investment strategies in a relatively cost efficient way.

28. Delivering a merger by 1<sup>st</sup> April 2020 is considered challenging, but possible. A significant amount of preparatory work has already taken place.

### **Progress to Date**

29. The Pensions Committees and Local Pension Boards at both funds have supported this merger initiative, subject to the completion of due diligence.

30. Initial discussions with MHCLG have also been held and they have indicated that they would be supportive of merger.

31. Discussions have also taken place with the other Councils in the Tyne and Wear Fund and they have all provided their support to this initiative.

32. The fact that a shared administration service is now in place makes a number of issues around a merger much simpler, especially with regards to the administration of members' records. It has also allowed the two funds to work together and get a greater understanding of how each other operates.

33. The main areas that need to be addressed now are around the Funding Strategy and other actuarial issues, and the Investment Strategy. A summary of the position on each of these areas is set out below.

### **Funding Strategy and Actuarial Issues**

34. With regards to actuarial and funding issues, a due diligence report from Aon has already been commissioned. Aon is the Actuary for both the Fund and Northumberland.
35. This report sets out a range of advantages and disadvantages and potential risks for both South Tyneside Council and Northumberland County Council.
36. With regards to advantages and disadvantages, the report highlights one significant advantage to South Tyneside Council and the Tyne and Wear Pension Fund and no significant disadvantages. The significant advantage is
- “Merger is likely to have a positive impact on STC’s reputation and for it to have the potential to become a regional hub of LGPS expertise.”
37. Aon also concludes that they have not identified any significant long term risks of merger in relation to either fund or Council.
38. The report does however identify some less significant long-term risks (with mitigations) and also highlights a number of significant short-term risks, many of which relate to the potential impact of the full merger on business as usual. Many of these risks can be mitigated through proper planning and budgeting, and ensuring appropriate resources are identified and dedicated to the transition from two funds to one fund.

### **Investment Strategy and Investment Pooling**

39. Initial discussions have already taken place between the funds and their investment advisors.
40. At the current time the investment strategies of both funds are broadly similar. To a large extent, however, the current position is irrelevant as the Fund is potentially moving to a new strategy.
41. The key question is whether this proposed new strategy would be appropriate for the newly merged fund. Hymans Robertson, the Tyne and Wear Fund’s Investment Advisor has undertaken some modelling work on this and has concluded that the proposed new strategy for Tyne and Wear would still be appropriate for the combined entity.

42. Consequently, if the merger were to progress both funds would need to move to the new strategy. However, both would be starting from different positions. The Tyne and Wear Fund has already started to make moves in this direction.
43. It has therefore been agreed that each fund would meet its own costs of moving to any new investment strategy. This would happen whether these asset moves take place before or after the merger date. For Tyne and Wear this will not result in any additional costs as we will be moving to the new strategy in any event.
44. One further issue that needs to be considered regarding the assets and a merged investment strategy is the pooling initiative and the move of assets to Border to Coast. At the current time Northumberland has not invested any assets with Border to Coast. It has been agreed that prior to any assets transferring, the implications of any potential merger will be considered to ensure that unnecessary costs are not incurred.
45. It is clear that further due diligence is needed on the asset part of the merger and how to align the investment strategies, and how this will link in with pooling.
46. This will continue to be discussed with Hymans Robertson, the Fund's Investment Advisor, and a proposal developed as part of the due diligence process.

### **Border to Coast Pensions Partnership**

47. South Tyneside Council and Northumberland County Council, along with ten other administering authorities, are joint owners of Border to Coast Pensions Partnership Limited. This is an investment management company that has been created to manage the assets of these funds, following on from the government initiative on LGPS asset pooling. Each administering authority has an equal share in the company.
48. The costs of participating in the company are allocated on two bases;
  - Governance related costs are shared on a one twelfth basis to align with voting rights
  - Investment related costs are shared based on the assets either invested or committed to be invested with Border to Coast.
49. Should a merger progress, Northumberland County Council will no longer be a shareholder in the company and the governance costs will then be split eleven ways, not twelve. Whilst this will increase the overall costs for the newly combined fund this will be recovered from a

wider employer base and will therefore, result in some efficiency savings.

50. As stated above, the other funds within Border to Coast have been made aware of the potential for Tyne and Wear and Northumberland to merge, and provisions for this were built into the legal documentation used to establish the company. Therefore this process will not come as a surprise to the other funds and no opposition to this is expected, despite the potential for increased costs.

51. The investment related costs should not change as a result of merger as the total size of assets in a merged fund will be the same as in two separate funds, albeit that there may be a change as to where these assets are invested.

### **Cost Efficiencies**

52. It is estimated that overall efficiency savings of at least 10% per annum, can be generated from the merger. These savings relate primarily to the reduction in the governance costs of only running one fund rather than two.

### **Costs of moving to Merger**

53. As the Northumberland employers will be a significant financial beneficiary from the merger, it has been agreed that Northumberland will meet the external administrative and support costs incurred on progressing with merger. This includes, but is not limited to;

- Actuarial advisors
- Investment Advisors
- Project Management
- Pensions Administration costs
- Communications to members
- Recharges for South Tyneside staff time outside of the Pension Service, such as IT support and payroll
- Any other additional external support

54. In addition to the administrative and support costs of moving to merger, Northumberland County Council will need to meet its own costs of transitioning its assets to align itself with the Investment Strategy of the Tyne and Wear Pension Fund.

55. The Tyne and Wear Pension Fund will not incur any additional external costs, as Northumberland has agreed to cover all external costs, which will be met out of their savings. The only costs incurred by Tyne and Wear will be opportunity costs for the staff involved in working on this project. These opportunity costs should not however, be significant as it has been agreed that external support will be used wherever possible.

### **Process to Complete Merger**

56. Should a decision be taken to continue to progress towards merger then the following steps would need to take place.

- Further due diligence and work on developing the business case to proceed and plans in relation to the implementation of the merger
- Formal agreement of both administering authorities to proceed
- Further discussions with the Ministry for Housing Communities and Local Government as the responsible Government department for the LGPS. The Local Government Pensions Scheme Regulations 2013 will need to be amended to permit the merger
- MHCLG would need to consult on amending regulations to permit the merger
- Final regulations would need to be made and laid

57. Aon has recommended that any project to commence implementation of a merger only commences once the first three steps are complete, although it is accepted that some steps could be progressed in parallel.

58. A target start date for merger is 1<sup>st</sup> April 2020.

59. With regard to the first bullet point the due diligence process is well progressed, but further work is still needed. This may not be finalised until early 2020.

60. The formal decision making at each Council is progressing and this is purpose of this report.

### **Conclusion**

61. Now that the shared service arrangement has bedded in, there is merit in pursuing the option of a merger between the funds.

62. The main benefit of merger for South Tyneside Council and Tyne and Wear is the increased resilience in relation to possible future changes and consolidation within the Local Government Pension Scheme (LGPS). This could help protect jobs in the Council and the region.
63. There are efficiency savings for both funds. Although it should be noted that because Tyne and Wear Fund is significantly larger it is already benefiting from economies of scale.
64. The due diligence process is well progressed and has not identified any issues which would prevent the merger from progressing. Further due diligence is continuing and this process could run into early 2020.
65. Council is asked to agree to progress with the merger of Tyne and Wear Pensions Fund and Northumberland County Council Pension Fund. It is proposed that the final decision on the implementation of merger will be delegated to Pensions Committee in consultation with the Leader and the Lead Member, Resources and Innovation. The final implementation will be subject to the satisfactory completion of the due diligence process.

### **Financial and Value for Money Implications**

66. The financial and value for money implications are set out in the report in paragraphs 52 to 55.

### **Legal Implications**

67. Any merger would require a change in the Local Government Pension Scheme Regulations 2013. These changes would remove Northumberland County Council as a body required to maintain a LGPS pension fund and transfer the assets and liabilities of the Pension Fund maintained by Northumberland to the Pension Fund maintained by South Tyneside.
68. MHCLG would be required to consult on any changes required to effect the merger.

### **Risk Implications**

69. The risk implications are considered as part of the due diligence process.

### **Equality and Diversity Implications**

70. An equality check has been carried out. No equality implications were identified.

## **Environmental and Sustainability Implications**

71. No environmental and sustainability implications arise directly from this report.

## **Options to be considered**

72. The option of not merging has been considered. However, there are considered to be good long term advantages of progressing with merger.

## **Recommendation**

73. Council is recommended to

- Agree to progress with the merger of Tyne and Wear Pension Fund and Northumberland County Council Pension Fund.
- Delegate the final decision on the implementation to the Pensions Committee in consultation with the Leader and Lead Member Resources and Innovation. This will be subject to the satisfactory conclusion of the due diligence process.

## **Reason for Recommendation**

74. To progress with merger.

APPENDIX

**Comparison of Tyne and Wear Pension Fund (TWPF) and Northumberland County Council Pension Fund (NCCPF)**

|   | <b>TWPF</b>  | <b>NCCPF</b> |
|---|--------------|--------------|
| Asset value as at 31 <sup>st</sup> March 2019         | £8.8 billion | £1.4 billion |
| LGPS membership as at 31 <sup>st</sup> March 2019     |              |              |
| • active  | 45,928       | 9,248        |
| • pensioner   | 49,551       | 8,806        |
| • deferred  | 41,488       | 8,682        |
| Total   | 136,967      | 26,736       |
| Number of employers as at 31 <sup>st</sup> March 2019 | 265          | 44           |
| Funding Level   |              |              |
| • 31 <sup>st</sup> March 2016                         | 85%          | 84%          |
| • 31 <sup>st</sup> December 2018 (estimate)           | 98%          | 96%          |
| Investment Performance to 31 <sup>st</sup> March 2019 |              |              |
| • Year  | 7.4%         | 6.9%         |
| • 3 Years   | 11.4% p.a.   | 11.2% p.a.   |
| • 5 Years   | 9.6% p.a.    | 9.1% p.a.    |
| • 10 Years  | 10.9% p.a.   | 11.2% p.a.   |

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## Pension Fund Merger

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**The following is a list of the background papers (excluding exempt papers) relied upon in the preparation of the above report:**

| <b>Background Paper</b> | <b>File Ref:</b> | <b>File Location</b>                                   |
|-------------------------|------------------|--|
| Joint Working Files     | N/a              | Head of Pensions<br>Office, South Shields<br>Town Hall |