

JOHN RAISIN FINANCIAL SERVICES LIMITED

London Borough of Barking & Dagenham Pension Fund

LGPS Update

A paper by the Independent Advisor
May 2019

Introduction

The purpose of this paper is to update the Pensions Committee on developments in respect of a range of important issues in the Local Government Pension Scheme (LGPS). This paper does not seek to address every significant issue relevant to the LGPS but rather those which appear to be the most relevant to the Barking and Dagenham Pensions Committee at this time. In respect of the Scheme Advisory Board project – Good Governance in the LGPS Project, Investment Pooling, Investment Cost Transparency, the Pensions Regulator and the LGPS this paper updates information provided in the Independent Advisor's previous LGPS Update paper which was presented to the 13 March 2019 meeting of the Pensions Committee.

The issues covered in this paper are:

- Scheme Advisory Board project – Good Governance in the LGPS Project
- Investment Pooling
- Investment Cost Transparency
- The Pensions Regulator and the LGPS
- The LGPS Cost Control process and advice issued on 14 May 2019 by the LGPS Scheme Advisory Board
- LGPS Consultation: Changes to the Local Valuation Cycle and the Management of Employer Risk

Scheme Advisory Board project – Good Governance in the LGPS

Hymans Robertson are now undertaking work to develop possible future options for the Governance of the LGPS. Following an initial fact-finding stage involving a sample of key stakeholders from across the LGPS Hymans Robertson have issued a survey to over 300 stakeholders on four Options in respect of possible Governance models. Every single LGPS Fund in England and Wales (approaching 90 in total) will be invited to respond. These four options are further developments of the two broad options of **Separation**

within existing structures and ***Separation via new structures*** referred to in the report presented to the 13 March 2019 meeting of the Pensions Committee.

The four Options which are now subject to consultation with stakeholders may be summarised as:

1. **Option 1 – Improved Practice:** Introduce guidance or amendments to the LGPS Regulations 2013 to enhance the existing LGPS Governance arrangements by making more explicit recommendations regarding the operation of local LGPS Funds. This might include Scheme Advisory Board (SAB) guidance on minimum expected levels of staffing and resourcing and representation on Pensions Committees together with amendments to the LGPS regulations to enhance the consultation in respect of the Funding Strategy Statement (FSS) and Investment Strategy Statement (ISS).
2. **Option 2 – Greater ring fencing of the LGPS within existing structures:** Greater separation of the Pension Fund management from the host authority. This would likely include a Pension Fund Budget set by the Pensions Committee at the start of the year with reference to the Pension Fund's Business Plan and needs. Any changes to the budget would need to be approved by the Pensions Committee. The Section 151 Officer could remain responsible for the pensions function but recommendations on the Pension Fund Budget would be made by a Pension Fund Officer to the Pensions Committee. Provision for charges from the host authority such as legal support or HR would be in the Pension Fund Budget and not be simply recharged at the host authority's discretion. Under this model policies over certain HR matters could potentially be taken by the Pensions Committee.
3. **Option 3 – use of new structures: Joint Committee (JC):** The Scheme Manager function (Administering Authority role currently undertaken by the London Borough of Barking and Dagenham) would be delegated to a Joint Committee. As London Borough LGPS Funds only consist of one major local authority a Joint Committee structure would only make sense in London if it comprised of a number of London Boroughs who presently each operate their own LGPS Fund.
4. **Option 4 – use of new structures: Combined Authority (CA):** Under this model an independent structure with the Scheme Manager function (equivalent to the Administering Authority responsibility) would be established and all Pension decision making would be made by this "Combined Authority (CA)." The CA would be a local authority in its own right and a separate legal entity but responsible only for LGPS matters. If this option were adopted in London it would only make sense if each CA took over the functions of a number of London Borough LGPS Funds. The CA would consist of Councillors from the Councils (in the case of London the London Boroughs) within the geographical area covered by the CA. Other Employer and Employee representatives may also be included in decision making. There is one example of a combined authority in the LGPS at present which is the South Yorkshire Pension Fund which covers the geographical areas of Barnsley, Doncaster, Rotherham and Sheffield Metropolitan Borough Councils.

The survey is to be supplemented by Hymans Robertson undertaking phone interviews, face to face meetings, workshops, conference sessions, webinars and conversations with professional bodies. The findings from all this activity will form the basis of a report to be

presented to the Scheme Advisory Board in July 2019. There will then be further consideration, including of legal implications, before a final decision by the Scheme Advisory Board (SAB) which is expected in the Autumn. Any decision by SAB which requires a change to the LGPS Regulations or primary legislation (an Act of Parliament) would have to be referred for further consideration (including undertaking any necessary further consultation) to the Ministry of Housing, Communities and Local Government (MHCLG). Therefore, any significant changes to the governance of the LGPS arising from this project will not be implemented until 2020 at the earliest.

Investment (Asset) Pooling

In January 2019 the Ministry for Housing, Communities and Local Government (MHCLG) issued a restricted Consultation on new Statutory Guidance in respect of Asset Pooling. The draft Statutory Guidance together with an eight page paper by the Independent Advisor entitled "*Observations on the draft LGPS Statutory Guidance on Asset Pooling issued 3 January 2019*" formed part of the Agenda of the Pensions Committee of 13 March 2019.

The Consultation closed on 28 March 2019. It is understood that an MHCLG representative informed the meeting of the LGPS Scheme Advisory Board held on 8 April 2019 that 93 responses had been received to the Consultation and that many of these were very detailed and would need very careful consideration.

It is also understood that amongst the issues raised in the Consultation responses were views that the Consultation had been carried out in a manner contrary to Cabinet Office Principles on Consultations and that some of the content of the draft Statutory Guidance was in reality a matter of Regulation rather than Statutory Guidance and therefore inappropriate for inclusion in the Consultation. At the date this LGPS Update paper was completed the MHCLG had not issued any further statement on the draft Statutory Guidance on Asset Pooling and the next stage in the development of the guidance framework for Asset Pooling was unknown.

Investment Cost Transparency

The LGPS Update provided to the 13 March 2019 Pensions Committee included a detailed commentary on the development of Investment Cost Transparency in the LGPS. It also explained the work of the Institutional Disclosure Working Group (IDWG) and the Cost Transparency Initiative (CTI) to build on the work undertaken by the LGPS Scheme Advisory Board and to extend Investment Cost Transparency to the pensions industry in general.

On 21 May 2019 the CTI published three templates for Asset Managers to report standardised costs and charges information to pension schemes. These are **The User Summary** (which can be used by pension schemes, and their advisers, to provide a summary of key information), **The Main Account Template** (which covers the majority of assets and product types), **The Private Equity Sub Template** (a cost disclosure template to be completed by asset managers of closed-ended private equity funds which where appropriate may also be used in relation to private debt investments). The CTI have stated that the templates "*have gone through a very robust process of development and testing, including a pilot process with 20 participants – both asset managers and schemes.*"

Also, on 21 May 2019 the LGPS Scheme Advisory Board issued a communication welcoming the release of the CTI templates and associated guidance. This communication included the statement that *“these templates will from today be adopted as an integral part of the Board’s Code of Transparency. Existing Code signatories which number in excess of 110 will be encouraged to make use of the new templates as soon as possible but will have a transition period of up to 12 months to ensure they can adapt systems without interrupting the current flows of data. New signatories, including those property and private markets managers who can take advantage of the new templates will be expected to use them immediately.”*

Clearly the issuing of the new templates by the CTI represents a further step in terms of openness, facilitating comparisons and scrutinising /constructively challenging Investment Managers charges. The new templates will enhance clarity of cost and value for not only the LGPS but other pension schemes too.

The Pensions Regulator and the LGPS

Section 17 and Schedule 4 of the Public Service Pensions Act 2013 extended the role of the Pensions Regulator (tPR) to include public service pension schemes including the Local Government Pension Scheme (LGPS) from 1 April 2015.

As explained in the LGPS Update presented to the Pensions Committee on 13 March 2019 the approach of the Pensions Regulator to pensions administration in the LGPS had caused, on 28 November 2018, the Chair of the LGPS Scheme Advisory Board in England and Wales (SAB) to write a robust letter to the Chief Executive of the Pensions Regulator (tPR). In response the Chief Executive of the tPR had stated that a senior member of her team would be available to attend the April 2019 meeting of the Scheme Advisory Board (SAB).

Two senior representatives of tPR – including the Executive Director of Front Line Regulation - attended the meeting of the SAB held on 8 April 2019. At this meeting they made a presentation. An Update note on the SAB website states that the main points made by the tPR representatives included:

- tPR’s work with the LGPS was about supervision not enforcement
- High risk cohort work has been positive with no need for any improvement plans or enforcement action
- Some concerns about some Employers and Fund Authorities still using paper data inputs and records. Results will be published in June 2019 on an anonymised basis
- Results of last year’s Governance and Administration survey would be published in May 2019
- Code of Practice 14 is the first requirement that Scheme Managers (Administering Authorities) should have regard to but there are other codes and practice notes that also need to be taken on board

The response of the tPR as reported in the Update note of the SAB meeting held on 8 April 2019 seemingly indicates a genuine intention by tPR to work positively with the LGPS going forward.

The LGPS Cost Control process and advice issued on 14 May 2019 by the LGPS Scheme Advisory Board

The Public Service Pensions Act 2013 introduced into the major public service pension schemes, including the LGPS, a cost control mechanism to seek to ensure the cost of providing pensions is kept within a range of costs. The Cost control mechanism is primarily concerned with calculating the cost of providing benefits to Employees of each of the major public service pension schemes.

For the LGPS in England and Wales there are two cost control mechanisms:

- The employer cost cap (ECC) process as operated by HM Treasury
- The future service cost (FSC) process as operated by the LGPS Scheme Advisory Board (SAB).

Either process can result in changes to the Scheme design and/or Employee contribution rates if the costs of the LGPS move sufficiently from a “target cost.”

A review of the 2016 LGPS Actuarial Valuation results (on a national basis) was undertaken by the Government Actuary Department (GAD) which determined that the costs of the LGPS had fallen below the future service “target cost” of 19.5%. Therefore, SAB proposed a series of improvements to the Scheme to bring costs back within the target cost. On the 21st December 2018 SAB issued a statement to LGPS stakeholders setting out the cost cap process, proposed SAB package of changes to the Scheme, and the recommendations to MHCLG Ministers to bring costs back within the “target cost.” The proposed improvements were due to be implemented from 1 April 2019 and included:

- Minimum Death-in-Service lump sum of £75,000 per member (not Employment)
- Revised member contribution rates and bandings, which take account of varying tax relief
- A 2.75% contribution rate for salaries between £0 and £12,850
- An expansion of Band 2, to cover salaries between £12,851 and £22,500, and a contribution rate reduction from 5.8% to 4.4%
- An expansion of the 6.8% contribution band from £45,200 to £53,500

On 30 January 2019, however, the Government announced a pause in the implementation of the cost cap process across public service pension schemes. The reason for this is that in December 2018 the Government had lost two cases in the Court of Appeal (the McCloud case relating to the Judicial Pension Scheme and the Sargeant case relating to the Firefighter’s Pension Scheme) which have a direct impact on the cost of all public service pension schemes. On 7 February 2019 the SAB received confirmation that the cost cap pause and the uncertainty caused by the McCloud and Sargeant cases announced by the Government on 30 January 2019 applies equally to the LGPS as to the unfunded public service pension schemes. Given that confirmation the SAB considered it had no option but to pause the SAB LGPS cost management process pending the outcome of the McCloud and Sargeant cases.

This challenge which is referred to collectively as the 'McCloud Case' concerns the transitional protections given to members of the Judges' and Firefighter's Pension Schemes when their pension schemes were revised consequent to the Public Service Pensions Act 2013. On 20 December 2018, the Court of Appeal found that these protections were unlawful on the grounds of age discrimination. The Government has applied to the Supreme Court for permission to appeal the decision.

If the protections are ultimately deemed to be unlawful, those members who have been discriminated against will need to be offered appropriate remedies to ensure they are placed in an equivalent position to the protected members. Such remedies will need to be 'upwards' - that is the benefits of unprotected members will need to be raised rather than the benefits of protected members being reduced. Protections were applied to all members within 10 years of retirement in all public service schemes.

Despite the actual court proceedings relating specifically to the Judges' and Firefighter's Schemes it is believed that the outcome will apply to all public service schemes. Given that if the decision of the Court of Appeal in the 'McCloud Case' is confirmed this will increase the cost of providing public service pension schemes, including the LGPS, is it therefore absolutely logical that the implementation of any amendments to public service pension schemes, including the LGPS, proposed under the cost control mechanisms be put on hold.

The timing and outcome of the "McCloud case" is presently unknown but will have an effect on the liabilities, and therefore the cost, of the LGPS. As each individual LGPS Fund is currently undergoing a full Actuarial Valuation the LGPS Scheme Advisory Board (SAB) issued advice (On 14 May 2019) under Regulation 110(3) of the Local Government Pension Scheme Regulations 2013 entitled "**Guidance for the 2019 Valuation in respect of cost cap process and the McCloud and Sargeant age discrimination case (McCloud).**" With regard to the approach LGPS Funds should take to the 2019 Actuarial Valuation the SAB Guidance includes the following:

Given the unknown nature in the scale and timing of any impact on liabilities as a result of Cost Cap and McCloud the following approach to the 2019 valuation is advised; That -

- I. If there is no finalised outcome on Cost cap/McCloud (in the form of a formal notification by MHCLG to administering authorities including a commitment by government to detailed benefit changes) by 31st August 2019 then the scheme benefit design used in the valuation should be as set out in current regulations.*
- II. In setting employer contributions for 2020 each administering authority should, with their Actuary, consider how they approach (and reflect in their Funding Strategy Statement) the risk and potential extra costs around this matter in the same way as they would for other financial, employer and demographic risks. This should be to allow employers to be aware of and make provision for the potential cost even though any additional contributions may not commence until after the outcome is known.*
- III. Once the outcome of Cost cap/McCloud is known and appropriate benefit changes are made, administering authorities should re-visit employer contributions under such statutory guidance or provision in regulation as may be available at that time....*

- IV. *At present the impact on exit payments and credits is unknown. Therefore, authorities should take account of regulatory requirements, FSS provisions and discuss the approach to be taken with their actuaries....*
- V. *In order to provide some assistance for authorities in assessing the potential impact of McCloud the SAB have commissioned GAD to estimate both an overall scheme McCloud cost and a 'worst case' McCloud scenario on a range of pay assumptions. These figures will be published on the SAB website as soon they become available.*

It is very helpful that the SAB has issued advice/guidance to LGPS Funds with respect to the 2019 Actuarial Valuation given the present uncertainty arising from the "McCloud case." Once the final judgement in this case is confirmed the implications will need to be considered by the Treasury and LGPS SAB in the context of the LGPS and any resultant amendments to the Scheme determined and put into effect.

LGPS Consultation: Changes to the Local Valuation Cycle and the Management of Employer Risk

On 8 May 2019 the MHCLG issued a Consultation entitled "***Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk***" This Consultation remains open until 31 July 2019. Proposals in the consultation include:

- To change the local Fund Valuation cycle of the LGPS from the existing three year (triennial) cycle to a four year (quadrennial) one with effect from 2024 – so as to align future LGPS Valuations at both local level and nationally (for Cost Control process purposes) with the Valuation timetable for other public service pension schemes
- That the 2019 local Fund Valuations result in Employer Contribution rates for three years (1 April 2020 to 31 March 2023) and a further local Fund Valuation be undertaken in 2022 resulting in Employer Contribution Rates for two years (1 April 2023 to 31 March 2025). Thereafter LGPS Valuations would take place in 2024 and every four years afterwards. The 2024 Valuation would result in Employer Contribution Rates for 1 April 2025 to 31 March 2029.
- The introduction of a power for LGPS funds to undertake interim valuations of a full or partial nature – this recognises the fact that the introduction of a longer valuation period of four years increases the scope for changes in assets and liabilities between valuations with a consequent potential increase in risks for LGPS Funds and their Employers
- A widening of the power that allows LGPS Funds (Administering Authorities) to amend an Employer's Contribution Rate in between valuations – this is a recognition that the introduction of a four yearly Actuarial Valuation timetable provides, in the words of the Consultation "*fewer opportunities to respond to changes in the financial health of scheme employers*"

- To allow LGPS Funds (Administering Authorities) to permit Employers which are ceasing to employ any active members and are exiting the LGPS the flexibility to spread exit payments over a period, where this would be interests of the LGPS Fund and other Employers as well as the Employer in question
- Introducing a 'deferred employer' status that would allow LGPS Funds to defer the triggering of an exit payment for certain Employers who are ceasing to employ any active members and who are considered to have a sufficiently strong covenant and make an ongoing commitment to meet their existing liabilities through a deferred employer debt arrangement. This commitment is intended to protect the LGPS Fund and other Employers. The Consultation suggests that *"this will be of particular help to smaller employers (such as charities) in managing their obligation to make an exit payment when they cease to employ an active member of the scheme"*
- A review of the arrangements for paying exit credits in cases where risk sharing provisions exist within the contractual agreements with an Employer.
- Removing the requirement for Further Education Corporations, Sixth Form College Corporations and Higher Education Corporations in England to offer membership of the LGPS to their non-teaching staff for new Employees.

The above is a brief summary of some of the proposals within this Consultation. Given the importance and likely effects of the changes proposed in the Consultation together with the opportunity to make comments and suggestions for the amendment of the proposals the London Borough of Barking and Dagenham should carefully consider the Consultation and if it considers appropriate formally respond by the closing date of 31 July 2019.

Conclusion

This paper has sought to inform and update the Pensions Committee on a number of important issues affecting the LGPS and with which it is desirable that the Members of the Committee are appropriately conversant.

John Raisin

30 May 2019

John Raisin Financial Services Limited
Company Number 7049666 registered in England and Wales.
Registered Office 130 Goldington Road, Bedford, MK40 3EA
VAT Registration Number 990 8211 06

"Strategic and Operational Support for Pension Funds and their Stakeholders"

www.jrfpensions.com