Non-Executive Report of the: **PENSIONS COMMITTEE** **20 June 2019**	TOWER HAMLETS
Report of: Neville Murton - Corporate Director, Resources	**Classification:**
LGPS (Local Government Pension Scheme) Current Issues and Updates	

Originating Officer(s)	Bola Tobun, Investment and Treasury Manager
Wards affected	All

Introduction

This report provides an update on general developments in Local Government Pensions Scheme arena and also the Scheme Advisory Board's key projects relating to the governance and administration of the Local Government Pension Scheme; specifically national initiatives to deal with inconsistencies across the Scheme for academies, the risks associated with Third-Tier employers and the conflicting interests at local authority employers who undertake the administering authority function.

REASONS FOR URGENCY

The report was not published five clear days in advance of the meeting. Therefore, before this item can be considered at this meeting, the Chair of the Committee would need to be satisfied that it is necessary to consider the update on the LGPS (Local Government Pension Scheme) at this meeting, the Committee may also take the view that it is important that there should not be an extended period without any member oversight on the current issues and updates on the LGPS.

Recommendations:

- Members of the Pensions Committee and the Pensions Board are asked to note the contents of the report which covers the following matters.
    1) LGPS Employer Cost Cap;
    2) New Fair Deal in the LGPS;
    3) Separation Project / Good governance in the LGPS;
    4) Academies Pension Cost;
    5) GMP Equalisation and the LGPS;
    6) Employer Exit Credits;
    7) Cost Transparency;
    8) Exit Payment Caps; and
    9) Changes to the Valuation Cycle and Management of Employer Risk

1. REASONS FOR THE DECISIONS

1.1 For effective and efficient management of the Fund.

1.2 There is a requirement for Members of the Pension Committee to be kept up to date with legislative developments as part of their decision making role.

2. ALTERNATIVE OPTIONS

2.1 No alternative.

3. DETAILS OF REPORT

3.1 LGPS Employer Cost Cap

3.1.1 Another key objective of public service pension reform is to ensure a fair balance of risks between scheme members and the taxpayer. To achieve this, the government will establish an employer cost cap mechanism in the new public service pension schemes. This will provide backstop protection to the taxpayer, and will ensure that the risks associated with pension provision are shared with scheme members.

3.1.2 The Treasury Directions provide the framework for this mechanism. All schemes must set a cap, expressed as a percentage of pensionable pay, and calculated in accordance with these Directions. If a future valuation shows that the costs of a scheme have risen more than 2 percentage points above the cap, or have fallen more than 2 percentage points below the cap, action will be taken to return costs to the level of the cap. This may be achieved via adjustments to member benefits accruing in respect of future service, or adjustments to member contributions.

3.1.3 The cost cap will control the cost risks associated with the new pension schemes, and the cost risks associated with active members who have service in the existing, pre-reform schemes (including those with transitional protection). Changes in costs which arise from technical or financial changes will not affect the cost cap. Only those which relate to members – such as changing expectations about life expectancy, salary growth or career paths – will be included in the cap mechanism.

3.1.4 The new framework for valuations of the public service pension schemes and the establishment of an employer cost cap will ensure that the full costs of providing the public service pension schemes are recognised and remain sustainable in the future.

3.1.5 On 21 December 2018 the LGPS Scheme Advisory Board (SAB) published its paper on cost management. The LGPS in England and Wales has a separate cost management process which is completed prior to finalisation of the HM Treasury public sector cost cap calculations.

3.1.6 Under this initial phase, the SAB are proposing an improvement to benefits equating to 0.5% of payroll, taking the cost back up to the long term target of 19.5% of payroll. The proposals are broadly as follows:

- Removal of Tier 3 ill Health
- A minimum lump sum death in service benefit of £75,000 per member (regardless of salary)
- Enhanced early retirement factors for all members who are active on 1st April 2019 in respect of their final salary-linked membership only
- Lower employee contributions for those with salaries at the lower end of the contribution band scale

3.1.7 The HM Treasury cost cap process will be completed once the outcome of the above proposals and subsequent consultation is known.

3.1.8 However, on 30 January 2019 the Government published a written statement which announces a pause in the cost cap process for public service pension schemes pending the outcome of the application to appeal the McCloud case to the Supreme Court. A copy of the judgement can be found clicking below: https://www.judiciary.uk/wp-content/uploads/2018/12/lord-chancellor-v-mcloud-and-ors-judgment.pdf and the statement can be found clicking: https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-01-30/HCWS1286/

3.1.9 As a result the LGPS Advisory Board (SAB) considers it has no option but to pause its own process pending the outcome of McCloud. The process has been paused and at present, there are no changes planned for April 2019. The employee contributions in April are to be levied as set out in current regulations and the Board would revisit the cost cap process once an outcome of McCloud is known.

3.1.10 In pausing the process, the SAB reserves its position to resubmit the benefit change recommendations made to MHCLG as a result of its own cost cap process or to submit a revised package of benefit improvements and contribution reductions when clarity in the matter has been achieved as this could potentially increase rates materially.

3.2 **New Fair Deal in the LGPS**

3.2.1 On 10 January the MHCLG published its latest consultation on the “New” Fair Deal, concerning the introduction of greater pensions protection for employees of LGPS employers who are compulsorily transferred to service providers. The consultation closes on Thursday 4 April, and we will be responding in due course. Click the below link for the Government consultation document: https://www.gov.uk/government/consultations/local-government-pension-scheme-fair-deal-strengthening-pension-protection

3.2.2 This latest consultation is long overdue, with the government having issued its New Fair Deal guidance back in 2013 and the MHCLG having had an initial consultation in 2016. As well as covering Fair Deal, it also includes a proposed miscellaneous amendment which will affect some employers who seek to end their participation in the Fund on merger.

3.2.3 Listed below are the main areas covered under the consultation and the proposals made within it:

a. A new definition of a “Fair Deal employer” is proposed.

b. Employees of a Fair Deal employer whose employment is compulsorily transferred to an external service provider will have their access to the LGPS protected. The establishment of a “broadly comparable” private sector scheme will no longer satisfy the Fair Deal requirements.

c. In a change from the previous policy, employees of Police and Crime Commissioners will be classed as Fair Deal employers. So the Fair Deal requirements will apply to all LGPS employers except further and higher education bodies, colleges and admission bodies.

d. In line with the current requirements, only those employees who transfer at the outset will have their LGPS access protected, but contractors can if they wish provide new staff with LGPS access with the consent of the fund and the original employer.

e. A simplified route of providing access to the LGPS is to be made available, whereby the transferring employees are treated for pension purposes as having remained with the original employer (known as the “deemed employer”). The aim is to facilitate those outsourcings where the original employer is retaining most or all of the pension’s financial risks (e.g. cases where the pensions costs are determined on a “pass through” basis).

f. At the same time, the existing admission provisions are to be made more flexible by including a specific facility within the LGPS Regulations for risk-sharing arrangements to be included within admission agreements.

g. For employees who are currently members of a broadly comparable scheme as a result of a previous outsourcing, and who wish to transfer their benefits from that scheme to the LGPS when that outsourcing ends, it will become compulsory for the LGPS to accept that transfer.

h. Whilst not specifically related to New Fair Deal, a facility is being introduced whereby if an LGPS scheme employer is merged into or taken over by another organisation, the responsibility for that pensions liability automatically transfers to the successor body. The aim of this is to give the LGPS recourse to the successor employer in cases where an employer is seeking to leave the Fund without paying off any exit debt.

3.3 **Academies Pension Cost**

3.3.1 Ministers agreed that the Department for Education (DfE), MHCLG and Government Actuary’s Department (GAD) should work together to pursue

solutions to achieve consistency across the LGPS in the administrative and funding arrangements for academy schools.

3.3.2 Two working groups have been set-up to address each specific issue, with activity currently ongoing to agree a standard data extract to simplify the administrative requirements and information exchanges for the academy sector.

3.3.3 To inform the funding review, GAD produced a report on 14 September 2018 which indicates that, in recognition of the DfE guarantee, on the whole, academies were treated consistently with Local Authority employers when funding plans were set for the 2016 Triennial Valuation.

3.3.4 LBTH PF acknowledges the status of the DfE as a central government department, supported by tax receipts, when considering the guarantee and covenant strength of an academy.

3.3.5 The GAD report should assist in discussions with regard to the 2019 Triennial Valuation, to provide assurance to the sector that the ongoing funding arrangements applied by LBTH PF are equitable to other participating employers underpinned by a statutory guarantee.

3.3.6 SAB's work is still ongoing to meet the stated objective of achieving a consistent and cost-effective operational and funding regime for academies participating in multiple funds across the LGPS.

3.4 **Separation Project / Good governance in the LGPS**

3.4.1 The objectives of the 'Separation Project' is to identify issues derived from current Scheme administration arrangements and to consider the potential benefits of increasing the level of separation to strengthen the delineation between the host authority and scheme manager role.

3.7.2 A report was produced by KPMG in 2015 which outlined a range of options, from removing the potential conflicts of interest for the Section 151 Officer, to each Fund operating as a standalone company.

3.4.3 The project was put on hold while pooling was in its initial stages. Notwithstanding the objectives of the project, there is a consensus among most Funds that conflicts of interests amongst officers and the Pensions Committee are well managed.

3.4.4 However, SAB has recently restarted the project and commissioned Hymans Robertson to facilitate a consultation on good governance structures for the LGPS. The purpose of the consultation is to consider how best to accommodate LGPS functions within the democratically accountable local authority framework in a way that ensures that conflicts of interest are addressed and managed appropriately and that the LGPS remains appropriately resourced and able to deliver its statutory functions.

3.4.5 SAB has asked Hyman Robertson to help to identify the real issues and potential options for change to the current arrangements which are

proportionate, pragmatic and would improve LGPS governance in these areas.

3.4.6 Through the consultation process, SAB will be seeking the views of as many stakeholders, representing all elements of the LGPS, as possible. Scheme stakeholders will be invited to complete a short online questionnaire which asks for examples of actual conflicts that can arise, your views on the effectiveness of current LGPS governance arrangements and your suggestions for improvement. Further stages of the consultation will include interviews and workshops with key stakeholders. This will allow the SAB to consult on a series of options that reflect the reality of LGPS governance as experienced by those who experience it first-hand.

3.5 **GMP equalisation and the LGPS**

3.5.1 A High Court judge has ruled that UK defined benefit pension schemes must compensate members for differences attributable to guaranteed minimum pensions (GMPs).

3.5.2 GMP accrued in the LGPS from 6 April 1978 to 5 April 1997. In broad terms, the GMP represents the minimum pension an occupational pension scheme must provide a scheme member as an alternative to the State Earnings Related Pension Scheme (SERPS).

3.5.3 GMPs are inherently unequal due to a number of factors, including the differing retirement ages for men (age 65) and women (age 60) and female GMPs accruing at a higher rate. While this can result in differences in GMP values, what has been deemed to matter more is what the members receive in total from the LGPS and the State and whether that leads to inequality.

3.5.4 HMT has stated that the High Court ruling “does not impact on the current method used to achieve equalisation and indexation in public service pension schemes”. We will need to wait and see if there are any specific areas where this may not be the case and any remedies required.

3.5.5 Responsibility for paying annual pension increases on different tranches of benefit is divided between the LGPS fund and the State (via the State Pension), depending on when the member was in employment and when they reached State Pension Age (SPA).

3.5.6 The introduction of the new Single State Pension in April 2016 brought uncertainty over the ongoing indexation of the GMP amount. This led to an ‘interim’ solution being announced by the Government for members reaching SPA between 6 April 2016 and at least 5 April 2021 (originally 5 December 2018), which involves the LGPS fund paying for everything i.e. both initial pension and all increases.

3.5.7 The above is only an interim solution and so the Government consulted on a permanent solution for public service schemes including the LGPS; it considered three options to address the issue –

1) case-by-case calculations;

2) extension of the ‘interim solution’ or
3) conversion of the GMP to scheme benefit.

3.5.8 The outcome of the consultation was issued in January 2018. With an eye on the GMP reconciliation exercise and impending court cases around equalisation, it decided to simply extend the existing ‘interim solution’ to 5 April 2021. It also stated its preferred longer term option to be conversion of GMP to scheme benefit. A further consultation on the methodology and legislation required to implement this preferred option is awaited.

3.6 Employer Exit Credits

3.6.1 The change to Regulation 64 provides more flexibility for administering authorities to manage liabilities when scheme employers cease to have active members in their Fund. Previously, any surplus has been retained in the Fund upon cessation.

3.6.2 It is included in the new LGPS (Amendment) Regulations 2018 which finally emerged on 19 April in response to a previous consultation which had closed in August 2016. The regulations have been laid in Parliament and come into force on 14 May 2018.

3.6.3 While some provisions have been backdated to 1 April 2014, this particular provision has not; effective from 14 May 2018, this has created a “cliff edge” for employers ceasing either side of the date, but avoids the many complications that backdating would otherwise have caused. The provision is expected to prove popular with employers participating after this date.

3.6.4 The timespan in which the payment must be made has been extended from one month after cessation of the employer to three months. Although the ability for an employer and administering authority to agree to extend the period has been retained, in practice three months will be a challenge and the pressure will be on. Both employers and administering authorities will need to provide and process final member information promptly, and allow sufficient time to obtain and consider a report from their actuary.

3.6.5 Hence administering authorities should review processes and procedures and ensure that employers understand the need for prompt provision of accurate leaver details for active members in order to achieve the tight timescales for payment out of surplus assets.

3.6.6 Administering authorities should also remember the provision in regulation 64(4) which enables them to obtain a certificate from their actuary adjusting the employer contributions - with a view to providing assets equivalent to any exit payment to the Fund by the exit date, which may still remain an attractive option to run a surplus down over the preceding years.

3.7 Cost Transparency

3.7.1 The move toward investment cost transparency is an important factor in the perception of the LGPS as being value-led. Increased transparency is now

included in CIPFA accounting standards and is an objective in the government's criteria for pooling investments. Finally, the introduction of MiFID II has seen a greater obligation on managers to fully report costs.

3.7.2 The LGPS Advisory Board's voluntary Code of Transparency was launched in May 2017. Signatories to the code commit to the principles of transparent reporting and agree to complete a template of costs for their clients and submit to third party compliance checks. In return they are named on the board's website and are able to use the code's "tick" logo in their marketing material.

3.7.3 Since the launch, the number of code signatories has grown at a steady rate, despite the restriction to listed assets, and now includes over 80 asset managers covering over £180bn of assets.

3.7.4 Following the release of the FCA's asset management market study in the summer of 2017, the Institutional Disclosure Working Group (IDWG) was formed in order to "gain agreement on disclosure templates for asset management services provided to institutional investors." The group, chaired by Dr Sier, includes asset owners, managers and academics, and currently developed a range of templates at both the account (manager) and user (trustee) levels to cover all of the major asset classes.

3.7.5 The Advisory Board (SAB) agreed to adopt the IDWG templates, when available, for use in its code. This decision was taken for a number of reasons including:

- Consistency of reporting. It makes sense for both managers and asset owners if a standard format for reporting is used across the institutional space.

- Adoption of the IDWG templates will provide a route into the Code for those alternative and property managers who until now have not been able to sign up. The Board also agreed to an amendment to the Code which enables these managers to sign up in advance of the arrival of the IDWG templates.

- The IDWG user template provides a useful summary of costs for LGPS committees together with the ability to drill down into the detail of account templates when required.

- Whichever body takes over, the work of the IDWG will continue to develop and maintain an effective and relevant set of templates.

3.7.6 The adoption of the IDWG templates will, however, require existing signatories to make changes to their reporting systems. This new templates differ in a number of ways. Firstly, there is a single listed template rather than separate segregated mandate and pooled fund versions. Secondly, there is an increased degree of detail.

3.7.7 Accordingly, SAB agreed that from the point of release of the IDWG templates, although new signatories to the code will be obliged to use them, existing signatories will benefit from a transition period of up to 12 months. Beyond the introduction of new templates, both the SAB and the IDWG will continue to face two important challenges. The first is to ensure LGPS committees and institutional trustees are able to make best use of the increased knowledge available to them.

3.7.8 The other, perhaps more daunting, challenge is to ensure that increased transparency is not mistaken by scheme stakeholders, the press and industry commentators for an increase in costs. It would be a shame if, in exposing costs in order to better manage them, we miss the opportunity to promote a better understanding of the mutually-beneficial relationship between asset owners and managers.

3.8 **Exit Payment Caps**

3.8.1 For a number of years, the Government has been considering the introduction of a cap on the settlement payments that are made to employees when they leave an employer. These payments normally take the form of a lump sum cash payment, or in the form of shares/share options. For employers participating in the LGPS, settlement payments will also include the value or "strain" of taking an unreduced pension for members over age 55.

3.8.2 In April 2019, the Government issued a further consultation on the introduction of a £95,000 cap on exit payments, which confirms the overall intentions and also addresses some of the issues that need to be resolved prior to implementation. This consultation is across the whole of the public sector, not just the LGPS, and closes on 3 July.

3.8.4 The introduction of the cap will lead to a number of actions / complexities that administering authorities, and employers, will need to be aware of. A separate consultation specific to the LGPS is expected in due course.

3.9 **Changes to the Valuation Cycle and Management of Employer Risk**

3.9.1 On 8 May the MHCLG announced a consultation under the title "Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk". The deadline for responding to the consultation is 31 July 2019 and the full document can be found here.

3.9.2 The key proposals in the consultation are as follows:

- to amend the local fund valuation cycle of the LGPS from three years to four years from 2024 (with an out of cycle valuation taking place in 2022).

- to introduce powers for LGPS funds to undertake interim valuations (in full or in part) and to widen the power that allows LGPS administering authorities to amend an employer's contribution rate in between valuations.

- the introduction of a ‘deferred employer’ status that would allow funds to defer the triggering of an exit payment for certain employers who have a sufficiently strong covenant.

- allowing an exit payment calculated on a full buy-out basis to be recovered over a period of time for cases where ‘deferred employer’ status might not be appropriate.

- a review of the arrangements for paying exit credits in cases where risk sharing provisions exist within the contractual agreements with an employer.

- a removal of 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 entrants.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 The changes to Survivor pensions will apply from the date civil partnerships and same-sex marriages were implemented; resulting in the need for Pension Funds to revisit all awards made under the current rules to those members affected and pays any additional sums due.

4.2 As it has been estimated that the cost to extend the improvement in survivors’ pensions to survivors of opposite sex marriages and cohabitating partners amounts to £2.8 billion across the public sector; there is no intent to take the provision forward at this time.

5. LEGAL COMMENTS

5.1 This report provides an update on a number of general developments affecting the Local Government Pensions Scheme. One of the functions of the Pensions Committee is to meet the Council’s duties in respect of the efficient management of the pension fund. It is appropriate, having regard to these matters, for the Committee to receive information about general developments affecting the Local Government Pensions Scheme. The Committee’s consideration of the information in the report contributes towards the achievement of the Council’s statutory duties.

5.2 When carrying out its functions, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don’t (the public sector duty).

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1 The employer’s contribution is a significant element of the Council’s budget and consequently any improvement in investment management and performance

will reduce the contribution and increase the funds available for other corporate priorities.

6.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

7. BEST VALUE (BV) IMPLICATIONS

7.1 The effective and efficient management of Fund assets and achievement of performance targets are crucial to the achievement of the funding strategy objectives and this is considered to be a good decision which can result in greater cost savings to the fund.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

9. RISK MANAGEMENT IMPLICATIONS

9.1 As proposed, the 'Technical Amendments to Benefits' consultation do not address the inequitable payment of survivor benefits for members in opposite sex marriages or cohabiting partners.

9.2 This continuing inequality will inevitably lead to a tangible risk of further legal challenge with an associated drain on administering authority resource.

9.3 The rigorous robust management of LBTH Pension Fund results in better quicker and more effective decision making which can lead to better Fund performance and reduction in the contribution required from the Council towards the Fund.

9.4 The monitoring arrangement for the Pension Fund and the work of the Pensions Committee should ensure that the Fund optimises the use of its resources in achieving the best returns for the Council and members of the Fund.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

10.1 There are no crime and disorder reduction implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report

- NONE

Appendices

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report

- NONE

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