COMMITTEE:	DATE:	CLASSIFICATION:	REPORT NO.	AGENDA NO.
Pensions Committee	**19 September 2013**	**Unrestricted**		

REPORT OF:	TITLE:
Interim Corporate Director of Resources **ORIGINATING OFFICER(S):** Oladapo Shonola – Chief Financial Strategy Officer	**General Update on Emerging and Developing Pension Fund Issues** **Ward(s) affected:** **N/A**

Lead Member	**Cllr Alibor Choudhury - Resources**
Community Plan Theme	**All**
Strategic Priority	**One Tower Hamlets**

1. SUMMARY

1.1 This report provides a general update to Members on emerging and developing issues in the local government pension scheme/fund sphere.

1.2 Issues discussed in this update include the following:

- Local Government Pensions Scheme 2014 (LGPS 2014);
- Academies Pension Fund Deficit Guarantee;
- Fund Governance and Structure based on Common Investment Vehicle principles; and
- Triennial Valuation.

2. DECISIONS REQUIRED

2.1 The report is an information only report, so Members are recommended to note this report.

3. REASONS FOR DECISIONS

3.1 There are no decisions to be made.

4. ALTERNATIVE OPTIONS

4.1 The London Borough of Tower Hamlets Pension Fund is bound by legislation to ensure that members of the Fund receive benefits as they fall due under the Fund's terms.

4.2 The Committee in discharging its delegated duties, as trustees of the Fund, need to be informed of developing and emerging issues as they relate to the LGPS, so that the Committee has all available information when making decisions. Therefore, it is appropriate that Members have knowledge of issues that may impact the Fund in the future.

5. BACKGROUND

5.1 There are a number of issues that continue to develop in relation to the governance, structure and valuation of the London Borough Tower Hamlets Pension Fund and the local government pension scheme at large.

5.2 This Committee has received reports in the past in relation to the Hutton Commission and its findings. Following Hutton, the government published its response and subsequently enacted new legislation (Public Service Pension Act 2013) to bring about some of the changes proposed by Hutton. The changes to the Scheme/Fund set out in the Act form the basis of the LGPS 2014 and these changes have also been a subject of a report to the Committee in June 2013.

5.3 Linked to the drivers of government reform of public sector pension is cost control. Presently, government is consulting on how best to structure LGPS Funds going forward so as to reduce deficits and improve investment returns. Government have made it clear that the current arrangement and number of pension funds is not tenable and that it is likely that the current number will be scaled back.

5.4 This update reviews the options on the table and discusses, in detail, one of the preferred options (Common Investment Vehicle) that should deliver savings whilst ensuring that local independence and decision making is retained is retain at local level.

5.5 The report also sets out the main points coming out of the recent statement on deficit guarantee for schools converting to academies by Government and the upcoming triennial valuation.

6 Local Government Pension Scheme 2014

6.1 The work of Lord Hutton was driven by three factors which were deemed essential to achieving comprehensive and viable reform of public sector pensions. These were identified as:

- Longevity – Current provision as funded by taxpayers is no longer affordable given that people are living longer and therefore spending longer in retirement;
- Flexibility – Pensions provision should be able to adapt to the modern labour force lives and works; and
- Fairness – the final salary scheme favours the highest paid staff at perhaps the expense of workers at the lower end.

6.2 The Public Service Pensions Act has been designed to address these issues in a way that is agreeable to all major stakeholders.

6.3 The main provisions in terms of impact on benefits/contributions of the PSP Act are summarised and compared with the 2008 scheme in the below table.

	Current Scheme (2008)	**Proposed (New) Scheme (2014)**
Benefit Type	Final Salary Scheme	Career Average Re-valued Earnings (CARE)
Accrual Rate	1/60th	1/49th
Pension Increases	Consumer's Price Inflation (CPI)	CPI
Retirement Age	(NPA)* 65	SPA**
Protections	Retirement age protections for members retiring before 2020	Retirement age protections for members retiring before 2020 and a no worse off guarantee if retiring before 2020.
Average Contribution Rate	6.5%	6.5% - No change
Alternative Benefits	N/A	50:50 Option***
Accrued rights	N/A	Protected

* Normal Pension Age (NPA) – currently at 65 years
** State Pension Age (SPA)
*** New or existing scheme members will be able to pay half contributions for half pension benefits

6.4 Other issues addressed by the Act relate to cost management through a dual process of a total cost target for the scheme and also a separate cost cap for LGPS employers – the targets/caps are yet to be decided.

6.5 The Act also redefines some of the governance roles, but the most significant change on the governance arrangement is the requirement to establish a Pension Board. Although, the legislation does not state when a Pension Board has to be established. Current expectation is that a Pension Board will likely need to be established some time after April 2014 in order fit in with most local authorities municipal calendars.

6.6 Although, the Act allows for further Regulation to be issued that would permit the same committee to perform the role of Scheme Advisory Board (Pension Committee) and Pension Board, the potential conflict and different roles that the two bodies are supposed to perform could make this difficult in practice.

6.7 The Pension Committee's role as the decision making body with delegated authority from the Council will potentially be difficult to combine with the scrutiny function of the Pension Board.

6.8 Additionally, legislation requires that equal numbers of employer and employee representatives are on the Pension Board. Current composition of the Pension Committee is as follows: seven voting members (all councillors) and two non-voting members on the staff/union side.

6.9 The proposals mean that there are potentially several permutations as regards to how the scheme governance structure can be set up going forward. Officers will await further guidance on this issue and will update Committee when more information becomes available. The Committee will be provided to review and agree any changes to the LBTH Pension Scheme's governance structure in line with legislative/regulatory guidance before officers embark on implementing the new legislation.

7 ACADEMIES PENSION FUND DEFICIT GUARANTEE

7.1 When a local authority maintained school converts to academy status, as part of their responsibilities as employers, they become responsible for the pension obligations of non-teaching staff that were previously enrolled in the LGPS. The basis for determining the recovery of any inherited deficit and on-going contribution rate is based on the risk the employer poses to the Fund.

7.2 The Committee has, over the past two years, admitted a number of Academies into the LBTH Pension Fund with deficit funding recovery period set at 14 years. This was deemed an acceptable recovery period despite the fact that current government legislation only guarantees academy funding for 7 years. So far, Members have taken the view that a shorter recovery period, of 7 years, may bring about extremely difficult financial challenges for a converting school. On the other hand, a 20 year period was deemed too risky for the Fund in the absence of any express guarantee that any funding shortfall will be met by the Government.

7.3 The Secretary of State for Education announced in July 2013 that his department will now provide a guarantee to meet the outstanding pension liabilities should an academy be forced to close down. The Government's motive for announcing this guarantee was to try to ensure that academies are treated equitably to the admitting authority when contribution rates are set. However, there are questions about the effectiveness of the guarantee from the Government as it comes with several caveats and can be withdrawn by HM Treasury at any time.

7.4 The Government guarantee is subject to certain conditions being met and also sets out instances that could lead to the guarantee being withdrawn, these include:

- Estimated contingent liability ceilings being exceeded;
- Projected costs are no longer affordable from within Department for Education's existing budget;
- Projected costs are not approved by HM Treasury; and
- HM Treasury reserve the right to remove the guarantee due to spending considerations or policy development.

7.5 Given that the government guarantee is significantly weakened by the conditions attached to it and does not expressly mitigate LBTH Fund risk exposure arising from the establishment of academies, officers are not persuaded that the statement by the Secretary of State is a full guarantee and should not lead to a change in approach by LBTH Pension Fund.

8 FUND STRUCTURE (COMMON INVESTMENT VEHICLE)

8.1 The Government launched a call for evidence into the governance structure of LGPS funds in June 2013 with the following high level objectives.

- Dealing with deficits; and
- Improving investment returns.

8.2 The call for evidence invites stakeholders to submit evidence in response to a number of questions around how best to achieve high level accountability to tax payers and other LGPS stakeholders, and how best to achieve the high level objectives set out in 8.1.

8.3 Cost management (Investment and Administrative) has been identified as one of the ways to achieve the high level objectives. In anticipation of government announcement, a study was conducted that suggested that a merger of London funds will generate significant cost savings. However, the basis of this report has been called into question by experts and the Chartered Institute of Public Finance and Accountancy(CIPFA)agreed that the findings of the report are flawed.

8.4 As an example, the benchmark costs used in the report are much higher than LBTH Pension Fund costs. Bearing in mind that the Fund has secured further savings (approximately £300k when compared to 2012/13 costs) from 2013/14 onwards and backdated savings of close to £2m, the LBTH Fund will not be necessary benefit from the savings identified by the report.

8.5 In line with most London Boroughs, officers agree that doing nothing is not an option, but are not persuaded that the creation of super funds (i.e. merging of all London funds) will achieve significant savings. In fact, the LBTH fund has outperformed some of the larger funds on investment management cost and investment returns over the years.

8.6 As an alternative to full mergers, the creation of common investment vehicles (CIV) will allow funds to retain local accountability whilst being able to achieve lower costs from investing on a pooled basis to achieve cost efficiencies,achieve greater returns and also improve flexibility of investment strategies.

8.7 The Society of London Treasurers are currently investigating the possibility of setting up a CIV that will enable London Boroughs to pool assets for investment purposes whilst retaining independence and keeping decision making on individual schemes local. The Committee will be updated as this initiative develops and any decision to invest through the CIV will have to be agreed by the Committee.

8.8 Specific benefits of the CIV approach are as follows:

- Achieves similar financial gains to a merger, but without the disadvantages and loss of governance and cost and potential challenges of merging all London funds;
- In line with government policy on localism, accountability to local taxpayers is retained as decisions made locally;
- Progressive implementation, so that the pace of change can be decided to suit LBTH;
- Retains local asset allocation decisions – this is essential as asset allocation differences between boroughs will reflect their different funding levels, cash flow positions and risk appetite -asingle fund removes this choice;
- Easier and swifter implementation of asset allocation decisions between different asset pools within the CIV;

- Relatively easy to implement versus considerable upheaval and costs that could accompany merger route;
- Easier access to asset classes such as infrastructure or housing for smaller funds, bringing down the costs of entry to such assets and enabling greater investment flows into these assets;
- Cost and efficiency savings from procurement for individual funds, by central procurement within the CIV; and
- Potential for performance enhancements by ability to switch to best in class with minimal costs.

8.9 Officers will report back to Committee following further guidance or response from Government on how it intends to restructure LGPS funds.

9 TRIENNIAL VALUATION

9.1 The triennial valuation of the LBTH Pension Fund is underway. Officers have submitted the required data to the actuary and meetings have been held to agree the assumptions to be used to value the Fund's liabilities and also approach to recovering any on-going Fund deficit in line with legislation.

9.2 The last full valuation of the Fund was undertaken in 2010 when the funding level was derived at 71.2%. The actuary calculated that the fund deficit in 2010 was £305m based on liabilities of £1,066m and Fund assets of £755m.

9.3 At the time of the last valuation, funding level had decreased from the 2007 level of 78% to 71.2% due mainly to investment underperformance and the continuing growth in mortality rate. Although, it is expected that investment performance will be better in this valuation cycle than in 2010, historic low bond yields, and therefore low discount rate on liabilities, point to higher estimated Fund liabilities which could take away any gains in improved investment performance.

9.4 A further update will be provided to Committee in November and a report will be brought to Committee in February which will outline the results of the valuation and the agreed contribution rate/value for future years and deficit funding for the next three years (2014/15 – 2016/17).

10. COMMENTS OF THE CHIEF FINANCIAL OFFICER

10.1. The comments of the chief financial officer have been incorporated into the report.

11. LEGAL COMMENTS

11.1 The report provides an update in relation to the Local Government Pension Scheme 2014. The framework for the new scheme has been established by the Public Service Pensions Act 2013, which received assent on 25 April 2013. The detail of the scheme is to be contained in Regulations, which have been the subject of consultation (the most recent of which ended on 2 August 2013) and which are yet to be finalised. The new scheme is expected to come into effect from 1 April 2014.

11.2 The report correctly refers to the fact that there will be a requirement for the Council to establish a pension board and that this will require an amendment to the Council's governance structure. The Department for Communities and Local Government carried out consultation in relation to the governance arrangements, which ended on 31 August 2013.

11.3 The report sets out the approach which officers have taken to the Government's guarantee in relation to the pension liabilities of academies. Should issue be taken with the Council's approach to the deficit funding recovery period for academies, then the terms of that guarantee may need to be the subject of legal advice.

11.4 The report refers to the fact that the triennial valuation of the pension fund is underway. This is to meet the requirements of Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008, which require the Council, as an administering authority, to obtain an actuarial valuation of its pension fundin every third year after 31 March 2010. The Council must obtain a report from the actuary in relation to the valuation and a certificate of rates and adjustments.

12. ONE TOWER HAMLETS CONSIDERATIONS

12.1 The Pension Fund Accounts demonstrate the financial stewardship ofthe scheme members and employers assets. A financially viable andstable pension fund is a valuable recruitment and retention incentive.

13. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

14. RISK MANAGEMENT IMPLICATIONS

14.1 The Committee is not required to make a decision on any of the matters in this report at this stage. Although, there are risk implications relating to the implementation of a new fund/governance structure and the long term sustainability of the Scheme as it relates to triennial valuation, the full implication of any such risks will only be known once further information has become available.

15. CRIME AND DISORDER REDUCTION IMPLICATIONS

15.1 There are no Crime and Disorder Reduction implications arising from this report.

16. EFFICIENCY STATEMENT

16.1 The Committee is not required to make a decision on any of the matters in this report, so there are no efficiency implications arising from this report.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D

LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

Brief description of "background papers"	Name and telephone number of holder And address where open to inspection