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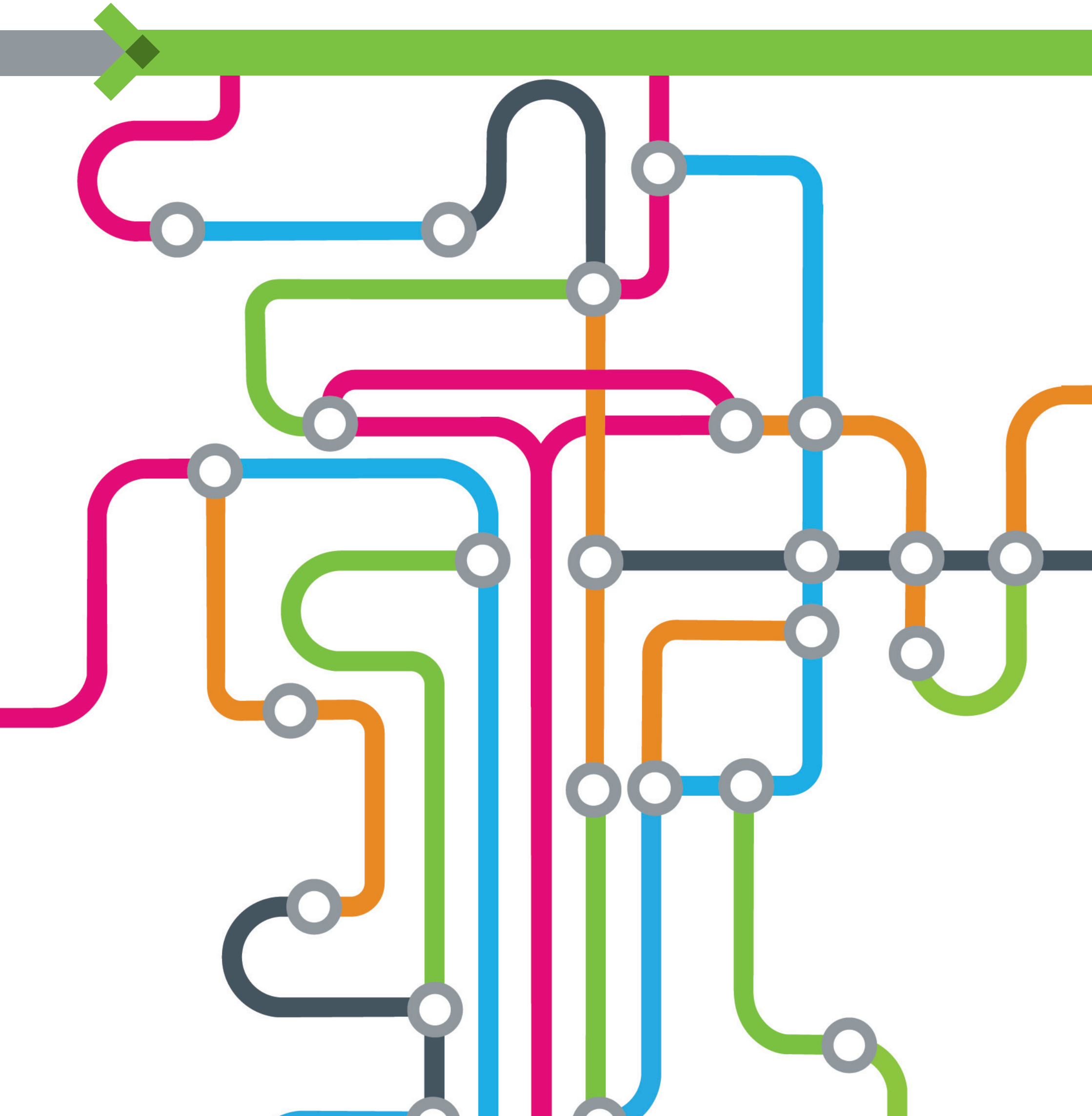
A brief guide

to the local government pension scheme



Introduction from John Wright

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Public sector pensions is a hot topic at the moment and with the emphasis on governance, taking on decision making responsibilities for an LGPS pension fund may feel rather daunting. This brief guide is designed to assist you in your role by familiarising you with some key areas:

- An overall understanding of the Local Government Pension Scheme (LGPS) and how it is set up
- The main areas of risk involved in running your fund and the management of these risks
- The sort of decisions that you may be asked to make

This brief guide has been written mainly for elected Members new to the role of dealing with an LGPS pension fund, however, it is also useful if you are already involved in pension committees or panels and looking for a summary of the important role you play in the 'stewardship' of your funds: an important role that gives you responsibility for the investment decisions of the fund and ensuring the scheme is administered effectively and fairly, with strong governance, on behalf of all its stakeholders.

With more than 90 years' experience of local government pension funds, Hymans Robertson has a long history of working with local authorities. We currently provide advice and support to over half of the LGPS funds in the UK. We use this extensive experience to help make life easier for those, like you, who are making decisions on the safe running of your fund.

I hope you find this brief guide helpful.

John Wright

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Basics of the Local Government Pension Scheme (LGPS)

The LGPS is a **defined benefit, funded** occupational pension scheme, set up under a Parliamentary Act. It provides pension benefits for those who work in the local authority arena and is open to employees of local government employers as well as a wide range of other public sector employers, including **admitted bodies**. The pension benefits under the LGPS are set nationally and are very secure as they are guaranteed by statute.

> Separate Regulations apply in England & Wales, Scotland and Northern Ireland. Historically the Schemes were almost identical in each area but in recent years differences have become more pronounced.

Although the LGPS is a nationwide scheme it is actually administered locally and is made up of a large number of standalone funds – normally administered by local authorities. It is the management of these funds that we consider in this booklet.

Definitions

CARE – From 1 April 2014 the LGPS became a **Career Average Revalued Earnings** based scheme. With pension accruing each year based on scheme members' earnings over their career. Previously the benefits under the scheme were on a formula based on length of service and salary on leaving.

Funded – this means that a fund is built up from contributions, investment income and growth in order to meet future benefit payments as they fall due. Most of the other public sector schemes are unfunded or pay-as-you-go scheme, which means that pensions are paid directly out of revenue, like many other public sector schemes.

Admitted bodies – an employer that has applied to participate in the scheme under an admission agreement – usually employers such as charities or contractors. Admitted bodies generally provide a public service which is closely linked to the functions of a local authority.

Key LGPS Facts

- Made up of 99 regional funds
- Over 4.1 million members
- Total fund size is over £140 billion
- Total expenditure on benefits is around £7 billion p.a.

Who's who in the LGPS

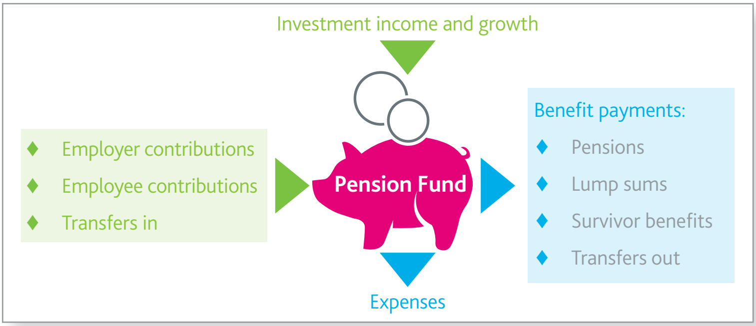
The main parties involved in the management and administration of the LGPS are:

- Department Communities and Local Government (DCLG) – the central Government Department, which has overall responsibility for the strategic management and policy making in relation to the LGPS in England and Wales. The Scottish equivalent is **Scottish Public Pensions Agency**, whilst the Northern Irish version is the **Department of the Environment**.
- The Administering Authority – often, but not necessarily, the largest council in the fund – they take on the role of pension fund administrators.
- The Pension Committee (or equivalent) – primarily made up of elected Members from the Council acting under delegated authority as the administering authority. Typically the other councils within the fund will also be represented. The committee usually has overall responsibility for the fund providing a similar function to that of trustees in private sector pension schemes.
- Officers – employees of the administering authority whose role it is to carry out the day to day administration and management of the fund on behalf of the elected Members. The actual day to day administration may be carried out by an in house team, an external contractor or a local authority shared service.
- Employers – local authorities, public service organisations, admission bodies and private contractors providing an outsourced service.
- Scheme members – the employees who build up pension benefits.
- Advisers – there are many experts whose assistance you may need to rely upon. The list includes auditors, lawyers, investment managers, actuaries, investment consultants and custodians.
- The Pensions Regulator – the Pensions Regulator ensures that codes of practice are complied with and high standards of governance are met.
- Other bodies – other groups that you will come across include LGA (Local Government Association), who provide guidance on the technical aspects of the LGPS, and CIPFA (Chartered Institute of Public Finance and Accountancy) who provide support on investment and governance aspects.

Your own officers will be able to provide you with details of the people involved in your fund, and your governance arrangements.

The Role of the Actuary

Your main concern when running a pension fund is to ensure that there are sufficient funds to pay for the pension benefits as they fall due and contributions are received at an appropriate level and in a timely manner. The following diagram shows how money flows in to and out of the fund.



Your fund actuary will carry out regular actuarial valuations of the fund with the following objectives:

- To comply with legislation (it is mandatory to have an actuarial valuation every 3 years)
- To monitor the ongoing health of the fund (e.g do you have enough money to pay the pensions)
- To recommend appropriate contribution rates for employers and
- To monitor the actual experience of the fund against the assumptions made

In order to carry out the valuation, assumptions need to be made about future experience. The most important decisions will be around the **discount rate** to use and the **mortality assumptions**. At valuation time, your actuary will provide assistance in determining these assumptions.

Definitions

Discount rate – the future payments due need to be discounted to give a present value. A discount rate is chosen to reflect the investment return that is expected on the fund.

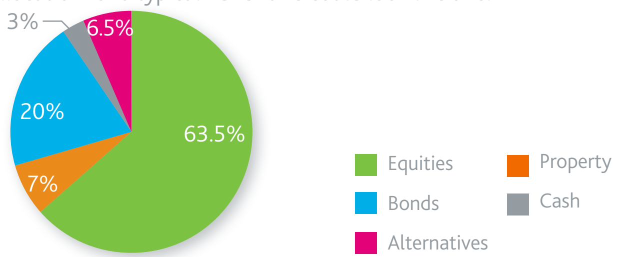
Mortality assumptions – one of the greatest unknowns for a pension fund is how long benefits will be paid for. People are currently living longer than they did in the past. The extent to which improvements are occurring needs to be actively monitored. At Hymans Robertson we have created Club Vita to do this.

Investment Decisions

One of your main tasks will be to decide where the fund's assets are invested. You need to decide on the overall strategy (i.e. the mix of asset types), and then the investment managers to do the actual buying and selling. Key things to keep in mind are:

- Of the asset classes **equities, property** and **alternative** assets are essentially return seeking. By contrast **bonds** are usually held for stability and security
- A high allocation to return seeking assets helps to keep pensions affordable. However, return seeking assets increase downside risk
- Asset and manager diversification (not putting all of your eggs in one basket) should help to reduce the downside risk
- A long term approach, seeking return, is generally considered appropriate – hence the high allocation to equities and alternatives seen in the LGPS world.

The asset allocation for a typical LGPS fund could look like this:



Definitions

Equities: "shares" in companies give an entitlement to dividends and the prospect of capital gains. Equities are expected to deliver a higher return than bonds over the long term.

Bonds: Bonds provide a regular income and are repaid in full at maturity. **Gilts** are issued by the UK Government and **Corporates** are issued by companies. Corporate bonds are higher risk than gilts and therefore have a higher interest rate. **Index-linked** gilts provide income and maturity payments which increase (or decrease) in line with inflation.

Property: Investments are usually in commercial property. Due to the size of individual properties and the need for diversification, investment is often through pooled funds.

Alternatives: Asset classes that add diversification by delivering returns in a pattern that differs from equities. Includes Hedge Funds, Infrastructure, Global Tactical Asset Allocation and Diversified Growth Funds.

'Must have' Documents

- Funding Strategy Statement
- Statement of Investment Principles
- Administration Strategy
- Governance Strategy
- Communications Strategy

What does my role on the committee entail?

It is important that you feel you have the appropriate knowledge and training to make these decisions. CIPFA have produced a Knowledge Skills Framework and code of practice in delivering good governance and what is expected from pension committees. During your period of office, the main decisions that you are likely to have to make are as follows.

- Deciding upon an appropriate investment strategy for your fund
  - Based on advice from your investment advisers
  - Setting performance benchmarks for the managers
- Dealing with investment managers
  - Selecting new investment managers by means of beauty parades
  - Monitoring manager's performance over time
  - Sacking managers where necessary
- Dealing with your fund actuary
  - Ensuring that you have an appropriate funding strategy for setting contributions
  - Agreeing contribution rates at the triennial valuation
  - Monitoring the progress of the funding level between valuations
- Ensuring that all relevant documentation is in order
  - Reviewing and updating the mandatory documents
  - Ensuring administering authority policies are up-to-date
  - Approving your pension fund accounts in time
- Be responsible for the risk management of the fund
  - Maintaining a risk register up-to-date
  - Ensuring that appropriate policies are in place to deal with the admission of employers into the fund, and the departure of employers from the fund
  - Ensuring the smooth administration of the fund for members and employers
  - Keeping an eye out for possible long term risks e.g. how your mortality experience is changing over time

For any further help or assistance on the topics raised in this booklet please contact us on

☎ 0141 566 7777

Knowledge and skills

Finance officers will be well aware of their responsibilities when finalising LGPS pension fund accounts of their requirement, under the CIPFA code of practice, that requires a statement that those responsible for the governance of the pension fund have the necessary skills. The CIPFA code of practice embeds the requirement to ensure those charged with pension scheme governance have access to the skills and knowledge to carry out their role effectively.

CIPFA have also published technical guidance for Representatives and Practitioners in the public sector within a Knowledge & Skills framework (KSF). The framework outlines the required skills - set for those responsible for pension financial management and decision making.

The six areas of the framework:

- Pensions legislative & governance context
- Pension accounting & auditing standards
- Financial services procurement & relationship development
- Investment performance & risk management
- Financial markets & product knowledge
- Actuarial methods, standards & practice

It is seen as best practice to sign up to the CIPFA code of practice and you may want to check that your fund has done so, and how the relevant skills and knowledge for yourself will be monitored and measured.

Workplace pension Reform

Public sector pension schemes have been under the microscope in recent years and this has included the LGPS.

The change to the LGPS which came into being from April 2014 in England and Wales, ahead of the other public sector schemes, includes a new benefit and contribution structure and introduce control costs.

The Public Sector Pensions Reform Act 2013 introduced a more unified legal framework and enables public sector schemes to outline their own controls.

The concept of automatic participation of workplace pension schemes was also introduced from 1 October 2012 whereby employees are auto enrolled into pension arrangements at least every three years and this has done a lot to improve pension provision from the LGPS with many new entrants deciding to not opt out.

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