

Pension Fund Committee

26 July 2021

Regulatory and Administration Update



Report of Paul Darby, Corporate Director of Resources (Interim)

Purpose of the Report

- 1 This report briefs the Committee on developments in matters that are both Local Government Pension Scheme (LGPS) specific, as well as providing an update on non-LGPS specific matters which are of interest.

Executive summary

- 2 There are a number of developments that will potentially impact the requirements placed upon the Fund, both specific to the LGPS and more generally. This report seeks to keep the Committee updated with those developments

Recommendation(s)

- 3 Committee is asked to note the report.

Background

- 4 This report provides an update to Committee on important pensions administration and governance matters that are currently relevant. The report is split into 2 main sections:
 - (a) LGPS specific matters, and;
 - (b) Non-LGPS specific matters that are of interest to the Committee.

LGPS Specific Matters

MHCLG Consultation – LGPS: Fair Deal – Strengthening Pension Protection

- 5 In January 2019, MHCLG launched a consultation that would strengthen the pensions protections that apply when an employee of an LGPS employer is compulsorily transferred to the employment of a service provider. If the proposed amendments are introduced, the option for staff to be granted access to a Government Actuary's Department (GAD) certified broadly comparable scheme will be removed.
- 6 MHCLG are currently considering the responses received, with a consultation response expected in due course. Officers will continue to monitor the position.

MHCLG consultation – LGPS: Changes to the Local Valuation Cycle and the Management of Employer Risk

- 7 In May 2019 MHCLG consulted on a number of changes to the LGPS, encompassing the following areas:
 - amendments to the local fund valuations from the current 3-year (triennial) to a 4-year (quadrennial) cycle
 - a number of measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle
 - proposals for flexibility on exit payments
 - proposals for further policy changes to exit credits
 - proposals for changes to the employers required to offer local government pension scheme membership
- 8 On 27 February MHCLG published a partial response to the consultation, covering proposals on exit credits only. MHCLG

confirmed their intention to amend the Regulations providing greater discretion to Administering Authorities over the amount of any exit credit. The Local Government Pension Scheme (Amendment) Regulations 2020 were subsequently laid before parliament, coming into force on 20 March 2020 with backdated effect to 18 May 2018. The Fund has published its policy in relation to Exit Credits, which will be reviewed in light of a recent High Court judgement that provided further direction to LGPS Funds.

- 9 MHCLG has also published a partial response in respect of employer contributions and flexibility on exit payments. Officers will work with the Fund's Actuary to update the Funding Strategy Statement after appropriate consultation with Scheme Employers. Committee will continue to be updated on the consultation.

Ongoing Consultation – Guaranteed Minimum Pensions (GMP)

- 10 In February 2017 the Treasury consulted on options for how the Guaranteed Minimum Pension (GMP) element of pensions paid to those members who will reach state pension age on or after 6th December 2018 should be indexed.
- 11 In January 2018 the Treasury published its response to this consultation, acknowledging that it is a complex area with more time required to identify a long-term solution. As a result, the existing interim solution was extended, covering those members of public service schemes reaching state pension age between 6th April 2016 and 5th December 2018 to those that reach state pension age on or before 5th April 2021.
- 12 On 23 March 2021 Her Majesty's Treasury (HMT) discounted conversion (of GMP into main scheme benefits) as their long-term policy solution and instead will make full GMP indexation the permanent solution for public service pension schemes. Currently members covered by the interim solution have their GMP pensions fully uprated by their scheme in line with CPI. The new policy will extend this to members whose State Pension Age (SPA) is on or after 6 April 2021.
- 13 The Fund's Actuary will provide further detail to the Committee and Scheme Employers at the Fund's Annual Meeting in November. In particular, the Actuary will outline the Funding implications of HMT's decision.

LGPS Scheme Advisory Board (SAB)

SAB Review – Academies

- 14 In 2017 SAB instigated a review of the participation of existing academies and commissioned Price Waterhouse Coopers to investigate issues of academy participation in the LGPS and prepare a report for the Board. The report made no recommendations but set out three broad types of approach or mechanisms to try and resolve these issues. These are:
- non-regulatory measures within the LGPS
 - regulatory measures within the scheme, and
 - measures outside of the LGPS, including through primary legislation.
- 15 The SAB review had been split between a funding working group and an administration working group. Work on the administration working group was put on hold due to competing work pressures and the project is no longer part of SAB's current projects. Officers will continue to monitor the position and update Committee if work on the project is revived.

SAB Review – Tier 3 Employers

- 16 In addition to the review of Academy participation, above, SAB also commissioned work in respect of 'Tier 3' employers participating in the LGPS. Broadly, Tier 3 employers are those employers which:
- (i) have no tax raising powers,
 - (ii) are not backed by an employer with tax raising powers;
 - (iii) are not an academy.
- 17 SAB had established a small working group to review concerns expressed by Tier 3 employers and the ways in which they may be resolved. The working group had been tasked with reporting back to the SAB with a set of recommendations for further consideration.
- 18 The project is no longer part of SAB's current projects. Officers will continue to monitor the position and update Committee if work on the project is revived.

SAB Review – Good Governance in the LGPS

- 19 SAB is currently examining the effectiveness of current LGPS governance models with a focus on standards, consistency, representation, conflict management, clarity of roles and cost. The

Board will consider a detailed paper in May 2020 which will likely result in new statutory guidance on Governance Compliance, with consideration in particular likely to be given to:

- (a) changes to the scheme's regulatory provisions on Governance Compliance Statements,
 - (b) revised statutory guidance on Governance Compliance Statements,
 - (c) independent assessment of Governance Compliance Statements, and;
 - (d) establishing a set of Key Performance Indicators (KPIs)
- 20 SAB have recently completed their report on Good Governance and submitted an Action Plan to MHCLG to take the recommendations of the project forward. A more detailed update to Committee, and overview of the recommendations proposed to MHCLG will be provided in due course.

SAB Review – Responsible Investment Guidance

- 21 In November 2019, SAB drafted guidance for Responsible Investment in the LGPS, to clarify the parameters within which investment decisions can be made with regard to the integration of ESG factors. Following feedback, SAB has decided to take stock until more is known about the government's position on the proposed climate change provisions in the Pension Schemes Bill and the implications of the Supreme Court's judgement involving the Palestine Solidarity Campaign. Committee will be updated as the matter progresses.
- 22 Notwithstanding this decision, SAB have progressed with further work in respect of Responsible Investment (RI), including the production of an RI A-Z Guide. It is intended that the A-Z Guide will provide LGPS stakeholders a "one stop shop for information, links and case studies in this fast growing and complex arena". The guide will evolve over time, as new entries are added. The A-Z Guide can be found online at the following link <https://ri.lgpsboard.org/items>.
- 23 The Board has also established an RI Advisory Group (RIAG). The main role of the group will be to advise SAB on all matters relating to RI. It will also be responsible for assisting the Board in maintaining the online A-Z Guide. The Group will also assist SAB in developing recommendations to MHCLG on how TCFD reporting should be applied to the LGPS.

Cost Control Mechanism/McCloud

- 24 The Committee has been informed previously of the Cost Control Mechanism in the LGPS and other public sector schemes which sets both a cost 'ceiling' and 'floor' in respect of the ongoing affordability of public sector pensions. This creates a "cost corridor" designed to keep schemes within 2% of target costs.
- 25 Members were informed previously that it had not been possible to assess the value of the public service pensions arrangements with any certainty due to the anticipated implications of the Court of Appeal judgements in McCloud and Sargeant.
- 26 The Fund's position on McCloud has been discussed previously, with the Actuary outlining in detail how the issue was to be reflected in the 2019. The approach taken added an additional 0.9% to the employer contribution rate for all employers at the 2019 valuation.
- 27 Before the impact of McCloud, provisional cost management assessments indicated floor breaches in most schemes, that may have resulted in an improvement to benefits or reduction in member contributions. At the request of HMT, GAD carried out a review of the Cost Control Mechanism across the public sector.
- 28 Following GAD's review, HMT are consulting on reforms to the cost control mechanism intended to "establish a fairer balance of risks between taxpayers and scheme members, and create a more stable mechanism". The proposed reforms would operate only in the reformed public sector schemes, would widen the existing cost corridor from 2% to 3%, and would introduce an "economic check" where there is a cost breach to ensure that broader economic conditions are considered.
- 29 Additionally, there are proposed changes to the discount rate used to determine contribution rates in the unfunded public sector schemes. This discount rate, however, is used in the production of actuarial factors in the LGPS. The Committee will continue to be updated on the position regards the Cost Control Mechanism in the LGPS.

Non- LGPS Specific Matters

Public Sector Exit Payments Caps

- 30 The Small Business, Enterprise and Employment Act 2015 introduced the concept of a 'public sector exit payments cap'. The legislation provides that exit payments to be paid to a person are not

to exceed £95,000. The 2015 Act provided the overarching principles of how the exit cap was to operate, but the detail was to be prescribed in regulations that were expected to soon follow.

- 31 After a period of delay the Treasury launched a new consultation on this matter in April 2019. Included in the consultation were draft regulations called 'The Restriction of Public Sector Exit Payment Regulations 2019' which provided detail on how the exit cap should operate from an employer's perspective.
- 32 Under the Regulations, the cap was to remain at £95,000 and include:
- redundancy payment(s);
 - any payment to offset an actuarial reduction to a pension arising by virtue of early retirement (known as 'strain on the fund' or 'early release' cost);
 - any payment made pursuant to an award of compensation under the ACAS arbitration scheme or a settlement or conciliation agreement;
 - any severance payment or ex gratia payment;
 - any payment in the form of shares or share options;
 - any payment on voluntary exit;
 - any payment in lieu of notice due under a contract of employment;
 - any payment made to extinguish any liability under a fixed term contract;
 - any other payment made, whether under a contract of employment or otherwise, in consequence of termination of employment or loss of office.
- 33 Most significantly for the LGPS, was the inclusion of the 'strain on the fund' costs are included towards the cap. These costs of allowing unreduced access to pension benefits for members over 55 can exceed £95,000 for scheme members with long periods of membership.
- 34 Separately to the Exit Payment Regulations, MHCLG consulted on further reforms to the LGPS Regulations that would accommodate the Exit Cap within the Scheme. As MHCLG's proposed changes were not implemented concurrently with the Exit Payment

Regulations, there was legal uncertainty for both LGPS Administering Authorities and participating employers due to the conflicting legislation.

- 35 On 12 February however the Exit Cap was unexpectedly disapplied, after the Treasury issued the 'Exit Payment Cap Directions 2021'. The Treasury will bring forward at pace revised proposals in respect of public sector exits. The Committee will be updated as further details emerge.

Mandatory TCFD Reporting

- 36 Using powers granted under the Pension Schemes Bill, the Department for Works and Pensions (DWP) has consulted on draft regulations requiring occupational pension schemes to meet climate governance requirements, publish a Taskforce on Climate-related Financial Disclosures (TCFD) report and include a link to the report in their annual report and accounts.
- 37 Whilst the regulations will not apply to the LGPS it is expected that MHCLG will bring forward similar proposals requiring TCFD disclosures in the LGPS. At the time of writing, consultation on such requirements in the LGPS is expected in September.
- 38 The Fund's pooling partner, Border to Coast Pensions Partnership (BCPP) are supporters of the Task Force on Climate-related Financial Disclosures (TCFD) and have just published their second TCFD report aligned with the recommendations. This covers the approach to climate change across the four thematic areas of Governance, Strategy, Risk Management, and Metrics and Targets. The report demonstrates the improvements and developments made across the four key areas. The report can be found online at the following link <https://www.bordertocoast.org.uk/sustainability/>.
- 39 BCPP will support Partner Funds ahead of any mandatory reporting requirements through the Officers Operation Group RI workshops, delivering training, and by providing reporting. BCPP have held discussions to understand all Partner Funds' requirements on carbon reporting on assets, including those that are currently not held in the pool.
- 40 A BCPP procurement for carbon data, including forward-looking metrics (scenario analysis), taking place this year will take into account the reporting requirements of Partner Funds for equity and fixed income portfolios. Obtaining carbon data for Private Markets is more challenging and BCPP are looking into solutions for these portfolios held in the pool.

- 41 An overview of TCFD was included in training for members of the Committee in December (materials included in Appendix 1). A more detailed report, and further training will be provided to the Committee as details of MHCLG's anticipated consultation on TCFD emerge.

UK Stewardship Code 2020

- 42 The UK Stewardship Code aims to enhance the quality of engagement between investors and companies to help improve long-term risk-adjusted returns to shareholders. The Fund has previously signed up the Code, and BCPP also publish a UK Stewardship Code compliance statement.
- 43 Due to the significant changes in the Investment Market since the introduction of the first Code, The UK Stewardship Code 2020 is now being introduced. This new Code expands on the previous requirements and comprises a set of 12 Principles which require reporting and disclosure on an 'apply and explain' basis.
- 44 The LGPS (Management and Investment of Funds) 2016 Regulations state that the responsibility for stewardship, which includes shareholder voting, remains with the Partner Funds. Stewardship, day-to-day administration and implementation have been delegated to Border to Coast by the Partner Funds, on assets managed by Border to Coast, with appropriate monitoring and challenge to ensure this continues to be in line with Partner Fund requirements. To leverage scale and for operational purposes, Border to Coast has, in conjunction with Partner Funds, developed a Responsible Investment Policy and accompanying Corporate Governance & Voting Guidelines to ensure clarity of approach on behalf of Partner Funds.
- 45 Officers are currently working with peers at BCPP Partner Funds to consider the new Code and will work together, and in conjunction with BCPP, to ensure compliance. A more detailed report will be provided to the Committee in due course.

Consultation on Minimum Pension Age

- 46 A consultation entitled 'Increasing the normal minimum pension age: consultation on implementation' was launched on 11th February and runs until 22nd April 2021. The consultation proposes that, due to increases in longevity and changing expectations of how long individuals will remain in work and in retirement, the minimum pension age would increase from 55 to 57 in 2028. The minimum age a scheme member can currently retire voluntarily in the LGPS is 55.

TPR Code of Practice

- 47 The Pensions Regulator (TPR) has consulted on a single Code of Practice to cover all regulated schemes. Presently, the Regulator has a specific Code for Public Service Pensions. Whilst the new Code does not extend TPR's powers in the LGPS beyond its existing remit on governance and administration, there are some concerns over how the provisions of the Code fit with the LGPS. SAB have responded on behalf of the LGPS.

Boycotts, Divestment and Sanctions Bill

- 48 The government's legislative programme was laid out in May. The programme includes a Boycotts, Divestment and Sanctions Bill the purpose of which will be to stop public bodies from taking a different approach to UK Government sanctions and foreign relations and will cover purchasing, procurement and investment decisions. Members will be kept up to date, as the matter progresses.

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