

	<b>Pension Board</b> <b>25 March 2020</b>
	<b>Report from the Director of Finance</b>
<b>LGPS Update</b>	

<b>Wards Affected:</b>	ALL
<b>Key or Non-Key Decision:</b>	Non-Key
<b>Open or Part/Fully Exempt:</b> <small>(If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)</small>	Open
<b>No. of Appendices:</b>	<ol style="list-style-type: none"> <li>1. Good Governance – Hymans Robertson Phase I Summary</li> <li>2. Good Governance – Hymans Robertson Phase II Summary</li> <li>3. Good Governance – Action Plan</li> <li>4. UK Stewardship Code – Hymans Robertson Summary</li> <li>5. LGPC Bulletin – November 2019</li> <li>6. LGPC Bulletin – December 2019</li> <li>7. LGPC Bulletin – January 2020</li> <li>8. LGPC Bulletin – February 2020</li> <li>9. Technical Bulletin – TPR Consultation</li> <li>10. DB Funding Code of Practice Consultation</li> <li>11. DB Funding Consultation Guide</li> <li>12. DB Funding Consultation Questions</li> </ol>
<b>Background Papers:</b>	<ul style="list-style-type: none"> <li>▪ N/A</li> </ul>
<b>Contact Officer(s):</b> <small>(Name, Title, Contact Details)</small>	Minesh Patel, Director of Finance Ravinder Jassar, Head of Finance

## 1.0 Purpose of the Report

- 1.1 The purpose of this report is to update the committee on recent developments within the LGPS regulatory environment and any recent consultations issued by the Ministry of Housing, Communities and Local Government (MHCLG) which have would have a significant impact on the Fund.

## 2.0 Recommendation(s)

- 2.1 The Committee is asked to note the recent developments in the LGPS.

### **3.0 Detail**

#### **McCloud Case**

- 3.1 On 21 December 2018, it was reported that the Court of Appeal ruled that transitional protections that protected older judges and firefighters from the public sector pension scheme changes in 2015, were unlawfully discriminatory. This case is known as the 'McCloud case'.
- 3.2 The Supreme Court denied the Government leave to appeal the McCloud and other associated cases on 27 June 2019 confirming that as 'transitional protection' was offered to members of all the main public service pension schemes, the difference in treatment will need to be remedied across all those schemes including LGPS. As the remedy will involve 'levelling up' member benefits, it is expected that any agreed outcome will increase the cost of LGPS pensions, however there is no certainty about how much this additional cost will be. Further information on the McCloud case has been provided in previous LGPS updates to the committee.
- 3.3 Given that no remedy had been agreed by 31<sup>st</sup> August 2019, Funds have been left to consider locally how best to manage the uncertainty and risk. The Fund Actuary has acted in line with SAB's advice and valued all member benefits in line with the current LGPS Regulations. The Fund has also elected to make an approximate allowance for the potential impact of McCloud in the 2019 valuation in the assessment of employer contribution rates by including a slightly higher required likelihood of reaching funding target.
- 3.4 As part of the external audit of the Pension Fund accounts, the auditors requested an estimate of the potential impact of McCloud, and if material, reflect the changes in the accounts. This was estimated at £3m at whole fund level in 2018/19. Depending on the liability profiles on different employers, the impact will vary across different employers.
- 3.5 It is understood that the LGPS will be treated separately from the rest of the public sector in respect of the McCloud remedy and that the remedy will involve the extension of some form of underpin to members in scope who are not currently offered protection.
- 3.6 It is expected that decisions relating to members in scope, the extent of final salary service protection, the requirement for retrospection and the inclusion of ancillary benefits (transfers, survivors etc) will be determined centrally by the LGPS. No remedy will be implemented before the end of financial year 2020/21. Therefore an estimate of the potential impact of McCloud will have to be included in the 2019/20 accounts.
- 3.7 Once the final remedy is known, it is expected that LGPS Funds will be required to identify affected cohorts, liaise with employers to obtain retrospective data, amend records, revisit calculations, uplift pensions in payment, communicate with the affected members while ensuring throughout, that the project has the appropriate level of governance.

## 4.0 Good Governance

- 4.1 As a result of significant cuts to local government funding over the last decade, the pooling of LGPS Investments and the increasing complexity in scheme benefits and administration, the Scheme Advisory Board (SAB) commissioned Hymans Robertson to examine the effectiveness of current LGPS Governance Models and to consider alternatives and enhancements to existing models which can strengthen LGPS Governance going forwards.
- 4.2 Hymans Robertson undertook a process of engaging extensively with stakeholder groups and fund types to consider four governance models, each of which would be assessed against set criteria. The process undertaken enabled identification of best practices within current governance arrangements as well as identification of additional ideas to strengthen governance within the current regulatory framework.
- 4.3 Results found that there was a majority preference in adopting a governance model which combined improved practice with greater ring fencing of the LGPS within existing structures. This involved the introduction of guidance or amendments to LGPS Regulations to enhance existing arrangements by increasing the independence of the management of the fund and clarifying the standards expected in key areas. In addition to this, results found there was a preference for clearer ring-fencing of Pension Fund management from the host authority, including budgets, resourcing and pay policies.
- 4.4 Following the analysis of these results, Hymans Robertson proposed that an outcome based approach to LGPS governance, with minimum standards, should be adopted rather than a prescribed governance model. In addition to this, Hymans Robertson proposed updating of relevant guidance and training requirements.
- 4.5 Following the approval of the good governance 'Phase I' report, the Scheme Advisory Board (SAB) asked Hymans Robertson to assist with the next phase of this project, which involved the defining of good governance outcomes and options for assessment of these outcomes. Further details of the initial results and analysis undertaken by Hymans Robertson are set out in Appendix 1.
- 4.6 Phase II of the good governance review was concluded by Hymans Robertson in November 2019 and several proposals were made regarding the production of further guidance and outcomes to be undertaken by administering authorities. These proposals were split into six main areas covering:
- General
  - Conflicts of interest
  - Fund representation
  - Knowledge and understanding of the LGPS
  - Service Delivery of the LGPS function
  - Compliance and Improvement

- 4.7 In summary, key proposals involved the publishing of an annual governance compliance statement to set out how compliant administering authorities have been with governance requirements within the LGPS. It is envisaged that the governance compliance statement will act as a summary, evidencing the Fund's position on all areas of governance and compliance. In addition to this, a proposal was made for guidance to be introduced for key individuals within the LGPS such as officers and pension committee members to have the appropriate level of knowledge and understanding to carry out their duties effectively. Hymans Robertson concluded by proposing that all administering authorities undergo a biennial independent governance review to be assessed by a SAB panel of experts. Further details of the proposals outlined by Hymans Robertson are set out in appendix 2.
- 4.8 Hymans Robertson have recommended that 'Phase III' of the good governance review contain draft changes to the current set of LGPS guidance produced by MHCLG. Next steps will also include SAB working in conjunction with the National Framework on establishing an independent governance review framework while also producing ten to fifteen KPIs for administering authorities to report the Fund's performance against.
- 4.9 Overall, the Fund supports these recommendations and in advance of this becoming part of formal regulations, the Fund has produced an action plan, to assess its compliance levels against each of the proposals made. This is set out in appendix 3.

## **5.0 UK Stewardship Code**

- 5.1 The Financial Reporting Council (FRC) has published an updated UK Stewardship Code, which has taken effect from 1 January 2020. The Code represents a new best practice standard for both asset owners and asset managers alike.
- 5.2 The requirements of the revised Code for asset owners and managers extend to establishing clear stewardship objectives, integrating stewardship in investment strategies, and adhering to a clearer and more elaborate set of reporting requirements. The Code comprises a set of 12 'apply and explain' Principles for asset managers and asset owners, and six Principles for service providers, including investment consultants.
- 5.3 Notable amendments to the UK Stewardship Code include the requirement for signatories to explain their organisation's purpose, investment beliefs, strategy and culture, and how these enable them to practice stewardship. Signatories are also expected to show how they are demonstrating this commitment through appropriate governance, resourcing and staff incentives. In addition to this, signatories are expected to take ESG factors, including climate change, into account and to ensure investment decisions are aligned with the needs of clients. Appendix 4 outlines further details to the key changes in the Code.
- 5.4 Organisations will remain signatories to the UK Stewardship Code until the first list of signatories to the 2020 Code is published. Existing signatories to the

Code will be required to submit a Stewardship Report that meets the FRC's reporting expectations in the 2020 Code by 31 March 2021 to continue to be listed as signatories to the UK Stewardship Code. Reports must be signed off at a Board level, by Chair, Chief Executive or Chief Investment Officer. Brent Pension Fund are currently awaiting further guidance for the construction of the Stewardship Report. Once received, officers will put together a draft report for the Board to consider ahead of submission.

## **6.0 Defined Benefit Funding Consultation**

- 6.1 The Pensions Regulator (TPR) issued a consultation on 3 March 2020 to seek views on principles for a new code of practice on defined benefit pension scheme funding.
- 6.2 In the Department for Work and Pensions (DWP) 2018 white paper 'Protecting Defined Benefit Pension Schemes', the government noted the defined benefit (DB) pensions funding framework is working largely as intended but acknowledged the need for improvement in a number of key areas and in particular:
- The need for trustees to focus on long term strategic issues as the scheme matures.
  - A lack of clarity about how to set prudent technical provisions and an appropriate recovery plan.
  - The need for greater transparency and accountability around the risks being taken.
- 6.3 Much of the current funding regime will remain, such as three yearly valuations and the requirement to determine technical provisions and maintain an appropriate recovery plan. However, the Pensions Schemes Bill introduces new requirements to help address the areas requiring improvement. The Pensions Regulator's consultation document is the first of two such consultations intended to inform a new DB funding code of practice to replace the existing code and reflect the legislative changes while providing trustees and sponsors with greater clarity on what is expected.
- 6.4 This first consultation set out in Appendix 10 highlights the key principles that The Pensions Regulator think should underpin the new framework. The second consultation, planned for later in 2020, will consider a draft code with more specific details reflecting feedback received from the first consultation.
- 6.5 The closing date of this consultation will be on 2 June 2020. Officers will be considering and formulating a response over the next few weeks. The Pensions Regulator anticipates that the new code of practice will come into force in late 2021. Comments from any member of the Board regarding the consultation should be sent to Rav Jassar ahead of the closing date.

## **7.0 Financial Implications**

7.1 This report is for noting, so there are no direct financial implications. However, the outcome of the consultations could have financial implications for the Fund, in particular the exit cap and the outcome of the McCloud case. Further work will be done with the Fund actuary to analyse the implications and report back to the committee.

## **8.0 Legal Implications**

8.1 Not applicable.

## **9.0 Equality Implications**

9.1 Not applicable.

## **10.0 Consultation with Ward Members and Stakeholders**

10.1 Not applicable.

## **11.0 Human Resources**

11.1 Not applicable.

**Report sign off:**

***Minesh Patel***  
Director of Finance