

	<p>Pension Fund Committee</p> <p>26 March 2019</p>
<p style="text-align: right;">Title</p>	<p>Regulatory Update</p>
<p style="text-align: right;">Report of</p>	<p>Director of Finance</p>
<p style="text-align: right;">Wards</p>	<p>N/A</p>
<p style="text-align: right;">Status</p>	<p>Public</p>
<p style="text-align: right;">Urgent</p>	<p>No</p>
<p style="text-align: right;">Key</p>	<p>No</p>
<p style="text-align: right;">Enclosures</p>	<p>Appendix A - MHCLG Statutory guidance on asset pooling</p> <p>Appendix B - Fair Deal Consultation</p>
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Summary

The Government continue to issue consultation documents on changes to the LGPS regulations. The paper discussed two new consultations (pooling criteria and fair deal) with an update on the cost cap proposals discussed at the January meeting.

Recommendations

The Pension Fund Committee note the ongoing consultations that may impact on the LGPS regulations.

1. WHY THIS REPORT IS NEEDED

- 1.1 The report provides a commentary on recent changes / proposed changes to LGPS regulations.

Cost Cap

- 1.2 It was reported at the last meeting that the Scheme Advisory Board had proposed changes to the LGPS benefit and contribution structure aimed at increasing the cost of future service for employers to revert to the Government's cost target. Following an adverse judicial review concerning age discrimination the Government and SAB have suspended their cost cap proposals and there is currently uncertainty as to the benefits that will be earned by members from 1st April 2019. It will be no surprise if the previously announced changes are introduced late and backdated resulting in additional workload for the administrator.

Pooling Criteria

- 1.3 The Government has issued a consultation on revising the pooling criteria and guidance. The deadline for responses is 28th March 2019. A summary of the revised criteria including a comparison with the current guidance is attached (appendix A). There are only a few aspects that are new and of interest, discussed below.
- 1.4 The requirements to pool and the scope to retain assets outside the pool (and to appoint new managers outside the LCIV for a limited period) remain unchanged. The emphasis on exceptional and temporary exceptions is somewhat weakened with a green light to new appointments until 2020 and the relaxed requirement to review assets outside the pool at least every three years.
- 1.5 The main point of interest (point 8 in appendix A) is that the boundary between asset allocation and implementation is to be decided at pool level i.e. LBs collectively. We know that LBs currently will want to retain a wide definition of strategy but overtime that might narrow as decisions on asset classes move to the LCIV.
- 1.6 There is also a provision (point 11) on sharing of transition costs. The example given is that if a fund already holds a manager that is selected by the pool and other funds incur costs in moving to that manager, all funds might be

asked to share the transition costs. I suspect this might be aimed at funds sharing an existing internal management capacity and would not apply to the LCIV.

- 1.7 Finally, there is a vague comment (point 6) on taking a long term and collective approach to the benefit of pooling. This appears designed to encourage pooling even if it comes at a cost as other funds may benefit from the greater pooling of assets. While clarification would be helpful, vague statements can be used to argue contrary positions and may offer a partial opt-out at some point in the future.
- 1.8 In summary, the new guidance is more a reminder that the Government is committed to pooling and lacks any timescales that will require urgent consideration of assets held outside of the pools.
- 1.9 A related issue is the requirement to obtain advice before appointing a fund manager as set out in the LGPS Investment Regulations which contain the following requirements.

“The authority must reasonably believe that the investment manager’s ability in and practical experience of financial matters make that investment manager suitably qualified to make investment decisions for it.

The authority must take proper advice in relation to the appointment and the terms on which the appointment is made.”

- 1.10 On the one hand we are required to pool our assets with the London CIV yet the regulations require that we must obtain advice before doing so. The revised pooling criteria does not address this issue. The consensus emerging is that from a regulatory requirement, the London CIV is the fund manager and the advice required by the regulations concerns the LCIV. However, from a practical perspective the Committee may still wish to seek advice on the underlying manager appointed by the LCIV and for each new appointment we will discuss whether new advice is required.

Fair Deal

- 1.11 A further consultation has commenced concerned ensuring that staff with LGPS membership rights whose employment is transferred continue to have access to the LGPS. The main aspects of the consultation are detailed in appendix B and summarised below.

- 1.12 The first aspect is that for the Council, its subsidiaries and academies, that when staff are transferred the option of a broadly comparable scheme will no longer be available. These members must (unless they opt out) join the LGPS. Offering a broadly comparable scheme is rare with the only known examples being when another public-sector scheme is available to transferred staff.
- 1.13 The second element is the terms 'deemed employer'. To avoid contractors who take on staff assuming the risks of becoming an admitted body, they can agree with the previous employer (usually the Council or an academy) that for pension purposes only the previous employer remains the employer and retains all the risks of being a participating employer. The contractor and the previous employer will then agree the appropriate contribution rate (or range) to be paid by the contractor and any balance of costs falls on the previous employer. These types of arrangement are currently available via pass-through arrangements that are outside the admission agreement.
- 1.14 Finally, the consultation proposes that should a scheme employer be taken over or merged that the new owner automatically joins the pension scheme without triggering a cessation. This is designed to avoid costly cessation bills.
- 1.15 These measures are designed to enhance the scheme member experience and make the LGPS easier to navigate for new employers. The provisions appear reasonable but as always there will be a degree of administration challenge to implement.

2. REASONS FOR RECOMMENDATIONS

- 2.1 The recommendation is for noting. No significant issues have been noted in the two new consultations.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

- 3.1 None – if available, alternatives will be considered when the proposals are finalised.

4. POST DECISION IMPLEMENTATION

- 4.1 Implementation is a matter for employers and the administrator. Should the proposals be implemented the ability of the administrator to implement will be monitored.

5. IMPLICATIONS OF DECISION

- 5.1 **Corporate Priorities and Performance**

5.1.1 The proposed changes will have a neutral impact on employers' contribution rates.

5.2 Resources (Finance & Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 As notes above higher employer's contributions may have budget implications for the Council.

5.3 Social Value

5.3.1 Contributing to the Pension Fund ensures that contributing members have a secured income on retirement.

5.4 Legal and Constitutional References

5.4.1 The Council's Constitution (Article 7) – includes Committee responsibilities for actuarial and funding matters, which are relevant to this issue

5.4.2 The Council is required to operate the pension scheme in accordance with the Local Government Pension Scheme Regulations 2013 and 2016, which will be altered if the Government proceeds with the recommendations in each consultation.

5.5 Risk Management

5.5.1 There are no risk management issues.

5.6 Equalities and Diversity

5.6.1 Pursuant to the Equalities Act 2010, the Council is under an obligation to have due regard to eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation, marriage and civil partnership.

5.7 Consultation and Engagement

5.7.1 Not required.

5.8 Insight

5.8.1 Not used - external report.

6. BACKGROUND PAPERS

- 6.1 Local Government Pension Scheme: Fair Deal – Strengthening pension protection

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/770060/Fair_Deal_in_the_LGPS_consultation.pdf

Statutory guidance on asset pooling in the Local Government Pension Scheme

- 6.2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/479925/criteria_and_guidance_for_investment_reform.pdf

Local Government Pension Scheme MHCLG Statutory guidance on asset pooling

Consultation closing 28 March 2019

Extract of Key Points from Consultation

1. In order to maximise the benefits of scale, pool members must appoint a pool company or companies to implement their investment strategies. [No change.]
2. It is for the pool companies to decide which investment managers to use for pool vehicles. [No change.]
3. Pool governance bodies, working with the pool company, should regularly review the provision of services to the pool, and the process of procurement, to ensure value for money and cost transparency. [Presumably this is a current function of the LCIV Shareholders Committee.]
4. Pool members, working with the pool company, should regularly review the balance between active and passive management in the light of performance net of total costs. [Another piece of compliance work. Not an onerous obligation.]
5. Pool members must establish and maintain a pool governance body in order to set the direction of the pool and to hold the pool company to account. [Already in place for the LCIV.]
6. Pension Committees should take a long-term view of pooling implementation and costs. They should take account of the benefits across the pool and across the scheme as a whole, in the interests of scheme members, employers and local taxpayers, and should not seek simply to minimise costs in the short term. [Somewhat vague in the context of pooling decisions. Does this mean we should pool even if costs more in the short-term?]
7. Strategic asset allocation remains the responsibility of pool members. Pool members are responsible for deciding their investment strategy and asset allocation, and remain the beneficial owners of their assets. [No change.]
8. Pool members collectively through their pool governance bodies should decide the pool's policy on which aspects of asset allocation are strategic and should remain with the administering authority, and which are tactical and best undertaken by the pool company. Pool governance bodies, when determining where such decisions lie, should be mindful of the trade-off between greater choice and lower costs and should involve the pool company to ensure the debate is fully informed on the opportunities and efficiencies available through greater scale. [New. This is designed to initiate a debate on the boundaries of strategy / asset allocation that are individual borough responsibility and implementation (pool responsibility) i.e. is strategy concerned with the split between growth and

hedging assets or traditional asset classes? Currently this decision is with each borough. The consultation envisages being decided at pool level. At present we can be fairly sure that London Boroughs will seek the widest possible definition of strategy.]

9. Providing pool members with asset allocation choices through an excessively wide range of pool vehicles or investment managers will restrict the pool company's ability to use scale to drive up value. On the other hand, maximising scale by significantly limiting asset allocation options may not provide all pool members with the diversification needed to meet their particular liability profile and cash flow requirements. Pool members should set out in their Funding Strategy Statement and Investment Strategy Statement how they, through the pool governance body, have balanced these considerations and how they will keep this under regular review. [Linked to the previous 'what is strategy' comment. Obligation is merely to report on how the collective London view was formed.]
10. Pool members should transition existing assets into the pool as quickly and cost effectively as possible. Transition of listed assets should take place over a relatively short period. [No change. The pooling timetable remains vague.]
11. Inter-authority payments (or other transfers of value) may be desirable in order to share these costs equitably between pool members. [New. By agreement. Cost of transitioning into a pool may be shared across boroughs if incurred unevenly i.e. If a borough is already invested with a manager selected by the pool it may be asked to share costs of others transitioning to that manager. As its by agreement, its likely to be a fractious discussion.]
12. In exceptional cases, some existing investments may be retained by pool members on a temporary basis. If the cost of moving the existing investment to a pool vehicle exceeds the benefits of doing so, it may be appropriate to continue to hold and manage the existing investment to maturity before reinvesting the funds through a pool vehicle. Direct property is carved out of the obligation to pool. [Greater emphasis on 'exceptions' and 'temporary' but no definitions.]
13. Pool members, working with the pool company, should undertake regular reviews (at least every three years) of retained assets and the rationale for keeping these assets outside the pool. [Surprisingly infrequent review given the exemption is both exceptional and temporary.]
14. Pool members should normally make all new investments through the pool company in order to maximise the benefits of scale. From 2020, when new investment strategies are in place, pool members should make new investments outside the pool only in very limited circumstances.
15. During the period of transition, while pool governance bodies and pool companies work together to determine and put in place the agreed range of pool vehicles, a pool member may make new investments outside the pool, if following consultation with the pool company, they consider this is essential to deliver their

investment strategy. This exemption only applies until the pool vehicles needed to provide the agreed asset allocation are in place. [Again, appears to cut across the earlier comments on non-pooling. Suggests we can do as we like until 2020 and even after that some exceptions to appointing through the pool are possible especially when the asset class is not presented by the LCIV.]

16. A small proportion of a pool member's assets [max 5%] may be invested in local initiatives within the geographical area of the pool member or in products tailored to particular liabilities specific to that pool member. [Another small exception that could prove useful.]
17. Pool members may invest through pool vehicles in a pool other than their own. [Opportunity for the LCIV to offer access to other pool's products. How do we keep track on what other pools have to offer?]
18. There is no target for infrastructure investment for pool members or pools, but pool members are expected to set an ambition on investment in this area. However, the Government expects pool companies to provide the capability and capacity for pools over time to move towards levels of infrastructure investment similar to overseas pension funds of comparable aggregate size. [No change.]

Fair Deal Consultation

1. The Government has issued a consultation on changes to scheme regulations that deal with pension protection for public sector employees whose employment is compulsorily transferred to a private sector provider. The consultation has three aspects,
 - Removal of the broadly comparable scheme option for staff transferring from scheduled bodies as a result of an outsourcing.
 - The introduction of the option of a 'deemed employer' for staff whose employment changes as a result of a contract award.
 - The automatic transfer of assets and liabilities when a scheme employer merges to avoid a cessation.
2. The consultation closes on 4 April 2019.

Restricting the option of a Broadly Comparable Scheme

3. Currently, when a service is outsourced by a scheme employer that involves the compulsory transfer of staff with right of access to the LGPS, the new contractor has a choice of offering LGPS membership through an admission agreement or offering an actuarially approved alternative pension arrangement that meets the definition of a broadly comparable scheme. The financial criteria for a scheme to be considered 'broadly comparable' are set by the Government Actuary's Dept, and were updated February 2019.
4. The consultation proposes the ending of the option to offer a broadly comparable scheme for specified current employers. These are the Council, its affiliates and academies, who are defined as 'fair deal employers'. Contracts involving transferred staff from admitted bodies and colleges may retain the broadly comparable scheme option, although these employers when awarding contracts involving the transfer of staff have the option of requiring continued LGPS access rights. So long as the protected employees remain wholly or mainly employed on the delivery of the service or function they retain the right to LGPS membership. By agreement, the current and new employer can also agree to offer LGPS membership to other employees of the service provider involved in the service who did not transfer from a current scheme employer.
5. These provisions are designed to enhance the protection for existing scheme members and extend that access for others who provide services that were previously performed by staff with LGPS membership rights. The Government has commented on the opt out for admitted bodies by stating "whilst we are committed to ensuring that public sector workers who are eligible for the LGPS are protected after being outsourced, we do not wish to limit the freedom that non-public sector organisations can reasonably expect in the total package they offer to their staff, including pay and pension." These new employers retain the admitted body route into the LGPS.

Deemed Employer Status

6. The Government has raised concerns with the complexity and risk for employers who participated in the LGPS as admitted bodies. There is a risk that the future service contribution rate can change and that when the last active member leaves a significant cessation debt is incurred. They also suggest that contractors increase their bid prices to cover these risks resulting in higher charges to the Council. They have therefore proposed the introduction of a 'deemed employer'.
7. The aim of the deemed employer is to enable pass-through under which the new employer pays a fixed or capped contribution rate and is protected against changes in contribution rates not due to their actions. The deemed employer is the former employer who retains the risks not passed to the new employer. Thus, if the Council outsources a service with transferred staff, the future service liabilities and assets will be linked to the Council and not the new employer. The contract between the Council and new employer will determine the new employer's contribution rate. The Council in this situation may retain the responsibility for any shortfall in contributions, as well as the benefit of any surplus.
8. It is hoped that this will enable smaller contractors to bid for contracts. Pass through is already available for admitted bodies and the purpose of the proposals is to ensure that these are fully explored before an outsourcing contract is agreed. The deemed employer status is an option available for the Council, its subsidiaries and academies. The Government also claim that this arrangement will reduce the number of admitted bodies therefore reducing the administration burden.
9. One of the administration challenges is late notification of a contract that gives rise to a transfer of employment. The draft regulations require that the service contract between a Fair Deal employer and the service provider state whether continued access to the LGPS will be provided via the deemed employer route or via the admission body route. This is intended to ensure consideration is given to pensions issues at an early stage, and the substantive differences between the two options are fully appreciated.

Automatic transfers of assets and liabilities in merger or takeover

10. The Government are proposing to amend the regulations to provide that when 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. In addition, where the successor body is also an LGPS employer with active members in another fund, the assets and liabilities must be automatically transferred to that fund and combined with the successor body's assets and liabilities.

11. The aim of the above is to avoid unintended cessations when an employer has no active members