

## PENSION FUND COMMITTEE – 8 MARCH 2019

### GOVERNMENT CONSULTATIONS

#### Report by the Director of Finance

##### Introduction

1. Since the December meeting of this Committee, the Government have published two consultation documents. The first of these is in respect of new pooling guidance to reflect the experience gained over the initial development of the new pooling arrangements. The second consultation is to introduce new regulations in respect of pension protections for those staff being out-sourced from a number of public sector employers.
2. This report covers the main issues arising from the two consultations and invites the Committee to agree responses to the Government in respect of both consultations. The report also covers the main implications of the LGPS (Miscellaneous Amendment) Regulations 2018 which came into force on 10 January 2019. We were also expecting a consultation on the implications of the cost capping mechanism. This report covers why that consultation has not been published.

##### Consultation of Revised Pooling Guidance

3. The Government issued revised guidance to administering authorities in relation to the pooling of LGPS assets on 3 January and ask for consultation responses to be submitted by 28 March 2019. Overall, there is very little new in the guidance, which simply consolidates the previous guidance and additional clarifications issued by Ministers in the interim. The guidance will have statutory backing.
4. The guidance covers seven areas as follows:

Definitions – key terms are defined to ensure consistency in future discussions on pooling. These appear sensible and helpful.

Structure and Scale – This sets out the Government's expectations that all pools will have an FCA authorised body at their centre (this may prove a challenge for the Northern Pool who are currently managing their listed equity investments outside an FCA structure.

There are a number of places within the guidance where the current wording needs to be tightened up to avoid inconsistencies and confusion, including 3.2 in this section, which states that "pool members may continue to decide if they wish to invest via in-house or externally managed vehicles". This suggests a

choice not current available within the Brunel (and other) pools, where there is no option for an in-house vehicle.

The main point of contention in this section is paragraph 3.6 which requires a regular review of active and passive management, with a presumption that pool members should consider moving from active to passive where active management has not generated better net performance over a reasonable period. It is unclear that this paragraph is relevant to the pooling arrangements. It is inappropriate to focus simply on the decision between active and passive as opposed to the wider asset allocation decisions, and indeed, it is inappropriate for the guidance to be one directional, as opposed to requiring consideration of moving from passive to active management where net performance would suggest appropriate. Finally, guidance based on performance over a reasonable period would need to define a reasonable period.

Governance – This section covers the role of the Pension Fund Committee and Pension Board in overseeing the work of the pool company, and in retaining their responsibility for strategic asset allocation.

Paragraph 4.4 confirms that Pension Committees should take a long-term view of performance, considering the wider benefits of pooling across the scheme as a whole, and not simply focus on minimising costs in the short term.

Transition of Assets – This section sets out the expectation that assets will be transitioned to the new arrangements as quickly and cost effectively as possible.

In paragraphs 5.4 and 5.5, it covers the circumstances where pool members may retain assets on a temporary basis, highlighting the potential cost of transition as a justification for retention. The current drafting though seems overly prescriptive with reference to maturity dates for investments and long-term investment contracts. These definitions would not cover our investments in listed private equity companies, which Brunel do not have the relevant authorisation from the FCA to take on. Paragraph 5.6 which requires regular review of all retained assets, with a presumption in favour of transition, but the opportunity to set out the rationale for retention could be seen as sufficient guidance with the comments from 5.4 and 5.5 included as examples only.

New Investments Outside the Pool – This section sets out the presumption that all new investments will be through the pool company except in very limited circumstances. These circumstances include local investments which would not normally exceed 5% of the total value of the pool member's assets. Paragraph 6.3 goes on to state that "Pool members may invest through pool vehicles in a pool other than their own where collaboration across pools or specialisation by pools can deliver improved net returns.". It is not clear whether the second part of this statement could lead to a competitive process between pools, or whether the specialist nature of one pool would need to be recognised by their own pool before investment was allowed.

Infrastructure Investment – There is little new here, with confirmation that the Government is not setting targets for infrastructure investment, but expects

pool companies to provide the capability and capacity for pool members to move towards levels of infrastructure investment similar to overseas pension funds of comparable size.

Reporting – The reporting guidance is comprehensive and likely to lead to some challenge in the earlier years as pool companies and members develop their understanding of the new requirements. These requirements are based on the CIPFA guidance “Preparing the Annual Report”.

5. Overall, subject to clarification or tighten of language in a couple of places, the new guidance is unlikely to place any undue burden on the Committee other than in respect of reporting. All administering authorities will need to continue to work with CIPFA and the pool companies to ensure that the requirements are achievable and add value for the reader of the accounts, and those with responsibility for overseeing investment costs and performance. This is reflected in the draft response at Annex 1 which the Committee are asked to agree to be sent to the Ministry of Housing, Communities and Local Government.

### **Consultation on Strengthening pension protection on out-sourcing**

6. The Ministry of Housing, Communities and Local Government also issued a consultation document on protecting pension rights on out-sourcing on 10 January 2019 with a request for consultation responses to be submitted by 4 April 2019.
7. This consultation document follows on from a previous consultation in 2016, which itself followed on from changes to the Fair Deal guidance in 2013, which covered central government and their agencies, the NHS, non-maintained schools (including academies) and other parts of the public sector under the control of Ministers.
8. This latest consultation seeks to bring local government into line with the provisions introduced for central government in 2013. In particular, it removes the option of providing a broadly comparable pension scheme for transferring staff, and instead gives them protected rights to remain in the LGPS. The proposals also provide a new framework for the management of pension risks on out-sourcing.
9. The consultation is set out in a number of sections with specific questions at the end of each section. These sections are:

Protected Transferees – The proposed regulations introduce the new concept of a protected transferee. Such an individual must be given access to the LGPS whilst they remain a protected transferee and have entitlement to membership of the scheme. A protected transferee is an individual who is an active member or eligible to be an active member of the LGPS, and who was employed by a Fair Deal employer (see below) immediately before the compulsory transfer of their employment under a contract to provide the service or function to a new service provider. An individual remains a

protected transferee as long as they remain wholly or mainly employed on the delivery of the service or function, even if the service is subsequently sub-contracted or re-let. The draft Regulations allow the Fair Deal employer and the service provider to grant protected transferee status to new staff employed on the delivery of the service or function, though such status can subsequently be removed by either party acting independently.

Fair Deal Employers – The draft regulations define a Fair Deal employer as any employer where members are admitted to the LGPS, with the exception of further and higher education corporations and sixth form college corporations and community admission bodies. The exceptions are based on these not being public sector bodies.

Transitional Arrangements – The draft regulations allowed for those people previously out-sourced under the previous pension protections to gain protected transferee status at the point their contracts are re-tendered. Where these individuals were previously protected through membership of a broadly comparable scheme, the draft regulations set out the basis for the calculation of transfer values to ensure a consistent approach which is seen as fair to scheme members, scheme employers and local taxpayers.

Risk Sharing – The draft regulations introduce the concept of a deemed employer as a means of addressing the current pension risks on out-sourcing contracts. These risks include the volatility of employer contribution rates at the tri-ennial valuations and cessation calculations (both particularly acute in small employers where demographic issues such as ill-health can have an dis-proportionate impact on future rates). These risks can lead to a number of employers being priced out of the tender process, and/or scheme employers having to pay a pension risk premium as part of their contract price. Under the new proposals, the Fair Deal employer will have the option to remain the deemed employer of the transferred staff and as such retain the majority of the pension risks. Any risks they wish to share with the new service provider would be set out in the service contract. There would be no requirement for an admission agreement under these arrangements, so removing one of the current delays in the process, providing greater certainty to the transferring staff.

Responsibilities for Employers – The new service provider, even under the deemed employer model will still be responsible for deducting employee contributions and passing these and relevant information through to the pension fund. The draft regulations require the service provider to provide sufficient and timely information. The draft Regulations also provide that unless otherwise covered in the service contract, the scheme provider is responsible for certain decisions which give rise to additional cost and for paying these costs over to the Pension Fund e.g. ill health, redundancy, flexible retirement.

Existing Arrangements – The draft regulations allow for the existing arrangements whereby membership of the LGPS is through an admission agreement to be retained, as this may still be the most appropriate route on

larger contracts. The draft regulations allow for risk sharing arrangements to be set out in the admission agreement.

Timely Consideration of Pension Issues – To try and ensure that pension issues are not ignored or forgotten about as part of the out-sourcing process, the draft Regulations require the service contract to state whether the continued access to the LGPS will be provided via the deemed employer route or via an admission agreement. Guidance will make it clear that the Fair Deal employer should set out their preferred approach at the point they are inviting bids.

10. The consultation proposals are in the main consistent with the preferred approach that the Council as Administering Authority has been recommending to the scheme employers for a number of years. As such, the draft response in Annex B is largely supportive of the proposals.
11. There is, though, an additional section to the consultation paper regarding the transfer of pension assets and liabilities where an LGPS scheme employer is merged into or taken over by a successor body. To avoid the unintended consequences of a cessation valuation being issued, it is proposed that the pension liabilities and assets automatically transfer to the successor body.
12. This issue was at the heart of the recent merger of two further education colleges, with Activate Learning taking on one of the Berkshire colleges. Officers refused to accept the request for a simple transfer of assets and liabilities as this would have meant that in the event that Activate Learning failed to meet its pension liabilities, these, including the unfunded liabilities of the previous Berkshire college would fall to be met by the scheme employers in the Oxfordshire Fund.
13. On this basis, the draft response included at Annex B has been written to oppose this part of the consultation proposals. The Committee are invited to endorse this approach and agree the draft consultation response.

### **The LGPS (Miscellaneous Amendment) Regulations 2018**

14. The LGPS (Miscellaneous Amendment) Regulations 2018 (SI 12018/1366) came into force on 10 January 2019, but include provisions which have effective dates of 17 April 2018, 5 December 2005 and 13 March 2014, amending the 2013 LGPS Regulations, and the LGPS Transitional provisions, Savings and Amendment Regulations 2014.
15. These amendment regulations:
  - give the Secretary of State power to issue statutory guidance
  - enable early access to pensions for members with a deferred benefit who left the scheme before 1 April 1998
  - require review and reassessment of surviving partner pensions from same sex marriage and civil partnerships, following the death of the scheme member. The amount of pension due must not be less than

would have been paid to a widow when comparing the time in the scheme, when left the scheme and partnership status at death.

16. The early release of deferred pensions brings this group into line with the changes introduced last year, (with exceptions that early payment can be requested even if in the same employment, and payment request does not need to be logged three months in advance with Pension Services) The provisions are backdated to 17 April 2018.
17. Increasing the benefit package for scheme members with a civil partnership or a same sex marriage, and whether the formal relationship is registered before or after the member left the LGPS requires research, reassessment and payment of pension arrears, if the member has died. Where the member has left the LGPS and taken a transfer of their accrued pension, or requested on retirement a single value for a trivial pension, again the 'package' is affected, but we await details and statutory guidance, before that part of the review can begin.
18. A civil partnership is recognised from December 2005 and the same sex marriage from March 2014, meaning potentially, a considerable number of leavers, and more urgently those where a death has occurred, will need review. Although a partnership may be recognised in December 2005, the member could have left the LGPS, many years earlier, kept a deferred benefit in the fund and still come within the scope of these changes.
19. For example, if a member left the scheme in 1994, registered the civil partnership in December 2005, and later died the survivor's pension in payment would currently be based on membership from 1988, but now will need to be from 1978 – or such later date the member joined the scheme.

### **Cost Capping Mechanism and the McCloud Judgement**

20. The final consultation we were expecting from the Government for this Committee meeting was to reflect the outcome of the cost capping mechanism, which now applies to all public sector schemes, following Lord Hutton's review of public sector pensions. The mechanism was established to ensure the cost to scheme employers of providing public sector pensions was kept within an agreed range of costs.
21. Within the LGPS, there are two elements to the cost capping mechanism, with one under the management of the Scheme Advisory Board (SAB) and one under Her Majesty's Treasury. Following the 2016 Valuation results, the calculations undertaken by the Government's Actuarial Department, indicated that the cost floor had been breached, and proposals had to be brought forward to improve scheme benefits to bring the costs back above floor level.
22. SAB did make proposals to the Secretary of State to address the issue, and it was consultation on these proposals that was expected. However, the Government has recently lost a case in the Court of Appeal which will have a direct bearing on the cost of all public sector pension schemes, and as such

HMT have suspended the cost capping mechanism until these costs can be clarified. SAB have similarly paused their process and withdrawn the proposals presented to the Secretary of State.

23. The Court Case, known as the McCloud case was a joint case brought by fire-fighters and judges, seeking a ruling that the transition arrangements introduced under the changes to the public sector schemes following the Hutton review were unlawful. The Court of Appeal upheld the case, finding that the transition arrangements discriminated on the basis of age, and the Government had not provided sufficient justification to support such discrimination. Whilst the case was specific to the fire-fighters and judges, it has been agreed the principles apply to all the public sector schemes including the LGPS.
24. The Government have indicated that they wish to appeal the decision to the Supreme Court, but it may take a few months to find out whether the Supreme Court will be willing to hear the appeal.
25. If the Supreme Court chose not to hear the appeal, the matter will be sent to the Employment Tribunal to determine suitable measures to address the discrimination. Such measures must be positive i.e. they can not reduce the position of those benefitting from the discrimination. It could take 9 months to a year for the Employment Tribunal to determine the appropriate measures. Once determined, these will need to be costs by GAD and the cost capping mechanisms re-run. At the earliest therefore, it is unlikely to be before the beginning of 2020 before any changes can be introduced.
26. If the Supreme Court hear the appeal, but find against the Government, the subsequent process will be the same, but likely to be up to a year later (i.e. 2021), given the time taken for the Supreme Court to hold the hearing. In the event that the Supreme Court upholds the Government's appeal, then the cost capping mechanism comes back into play, but it is likely that new proposals will need to be brought forward, as the Government has stated that the changes will still be effective from April 2019. Careful consideration will therefore need to be given to the suitability of any proposals and how they could be backdated to April 2019.
27. At the present time, the Scheme Advisory Board is consulting on the approach to be taken to the 2019 Valuations in light of the uncertainty. Whilst it is clear that there will be increased costs either under the cost capping mechanism or via any means to address the discrimination determined in the McCloud case, without knowing the detail of the proposals, it is unknown how these costs will fall between scheme employers. It is therefore likely that 2019 Valuations will need to proceed based on known costs, and this Committee will need to determine how to manage the risk of subsequent increases in costs.

## **RECOMMENDATION**

**28. The Committee is RECOMMENDED to:**

- (a) approve the consultation response in respect of pooling guidance as contained in Annex 1;**
- (b) approve the consultation response in respect of pension protection as contained in Annex 2;**
- (c) note the changes introduced under the LGPS (Miscellaneous Amendment) Regulations 2018, and ask for a further report on the implications once the process and costs become clearer; and**
- (d) note the position in respect of the cost capping mechanism and consider it further as part of the 2019 Valuation process.**

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