Pensions Committee

2.30 p.m., Tuesday, 23 September 2014

Reform of the Local Government Pension Scheme in Scotland and Regulatory Update

Item number	5.9
Report number	
Executive/routine	
Wards	All

Executive summary

Progress continues to be made towards implementation of a new Local Government Pension Scheme (LGPS) in Scotland from 1 April 2015. LGPS (Scotland) Regulations 2014 (Benefits and Administration) have been published, as have the LGPS (Transitional Provisions and Savings) (Scotland) Regulations 2014. Further regulations covering scheme governance will follow over the coming months. Although very significant progress has been made, the implementation timescale remains very tight and much work remains to be done.

Consultation on the structure of the LGPS in Scotland is expected to be a focus of attention for the new national Scheme Advisory Board, once this is constituted in April 2015.

Coverage of matters affecting the LGPS in England and Wales and other pensions reform matters is included for reference.

The Law Commission's report on "Fiduciary duties of investment intermediaries", published on 1 July 2014, is summarised.

Further regular updates will be provided to Pensions Committee.

Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	

Report

Reform of the Local Government Pension Scheme in Scotland and Regulatory Update

Recommendations

1.1 Pensions Committee should note the regulatory update provided in this report.

Background

Reform of the LGPS in Scotland 2015

2.1 This report is the latest in a series of regular updates on public service pension reform and specifically the implications of fundamental change to the design and governance of the Local Government Pension Scheme (LGPS) in Scotland.

2.2 Heads of Agreement on the new LGPS in Scotland were published on 12 December 2013.

2.3 This Council has responded to a consultation on proposals for governance of the new LGPS.

Main report

LGPS in Scotland 2015 – Benefit Regulations

3.1 Following the recent consultation, LGPS (Scotland) Regulations 2014 (Benefits and Administration) 2014 [SSI 2014/164] were made on the 5 June and laid before the Scottish Parliament on the 9 June 2014. These regulations include the detail of the new career average revalued earnings (CARE) scheme.

3.2 Transitional Regulations establish the legislative basis for the preservation of benefit entitlements from the current final salary scheme to the new CARE scheme. In response to concerns expressed to the Scottish Government as to the potential impact of delay, consultation on these transitional regulations was restricted to six weeks. The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 (SSI 2014/233) were laid in the Scottish Parliament on 22 August 2014.

3.3 Additionally, detailed guidance is expected to be produced imminently in order to provide requisite clarity to payroll and pensions administration software suppliers. Specific aspects encompassed by this guidance included the new "50:50" option, part-time contributions based on actual pay, additional child related leave and the determination of assumed pensionable pay in certain circumstances e.g. maternity or sickness. Clarification of the application of Certificates of Protection in a CARE scheme will follow.

LGPS in Scotland 2015 – Governance

3.4 Scottish Local Government Pension Scheme Advisory Group (SLOGPAG) continues to consider the details of a new governance structure for the LGPS. The Heads of Agreement on Governance are attached in the Appendix. Regulations are expected to be issued for consultation in October 2014.

3.5 A requirement for a model constitution for Pension Boards, together with a locally determined appointments process is anticipated. Much remains to be done in order to establish such Pension Boards across the eleven funds in Scotland by 1 April 2015. Over the coming months, the Fund intends to consult with employers and members and the existing Consultative Panel on implications on the Fund's governance. It is anticipated that changes to the Consultative Panel's constitution will be required.

3.6 A new Scheme Advisory Board for the LGPS in Scotland will also be established by 1 April 2015.

LGPS in Scotland 2015 – Communications

Preparatory work on member and employer communications material continues to be progressed by the SLOGPAG Communications Sub-Group. Lothian Pension Fund is represented on this group.

3.7 Lothian Pension Fund recently provided Annual Benefit Statements to its active membership. This included a separate newsletter which gave members more information on the scheme changes and a link to the national web-site.

3.8 The Local Government Pensions Committee (LGPC) has scheduled training events for September 2014 in Glasgow, Aberdeen and Edinburgh. The LGPC is a UK wide body, with councillor representation from the respective Local Government Associations and CoSLA. These sessions are aimed at assisting employers to understand their obligations for LGPS 2015 and are therefore targeted at payroll and HR specialists. Lothian Pension Fund has alerted its employers to the availability of this training.

Public Service Pensions (Valuation and Employer Cost Cap) Direction 2014

3.9 In June 2014, HM Treasury issued the Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Direction 2014 order. This confirms the arrangements for the application of an employer cost cap and notional valuation at a national scheme level.

LGPS in England and Wales 2014

3.10 Despite the increased complexity of CARE benefits and the lateness of transitional regulations, the initial assessment of the implementation of the new scheme on 1 April 2014 is that local authorities have coped well with the additional administrative demands, "so far so good" being the general opinion. That said, the immediate priority for administrative authorities is the correct payment of pensions and therefore it will be some time before the accuracy of new scheme record-keeping can be rigorously tested.

LGPS in England and Wales - consultation on structural reform

3.11 The formal consultation on opportunities for collaboration, cost savings and efficiencies for the LGPS in England and Wales, issued by the Department for Communities and Local Government, closed on 11 July 2014. This proposed the use of collective investment vehicles to invest more efficiently and the greater use of passive management for listed assets. It is anticipated that changes would be implemented by May 2015.

3.12 The Shadow Scheme Advisory Board for the LGPS in England and Wales (SSAB) published its response on the closing date. A link to the full SSAB submission, together with further links to responses from the Local Government Association (LGA) and Hymans Robertson LLP, is provided later in this report.

3.13 In summary, "the SSAB agrees that collective investment is a positive step and could bring benefits through scale. However it believes that: CIVs should not be limited to two (one for passive and one for alternatives). Although maintaining asset allocation at the local level is appropriate, and should be supported, there may be times when, for the benefit of the fund or the Scheme, some flexibility in this view may be required. The number and type of collective investment arrangements should be limited in order to access the benefits of scale but they should be allowed to develop organically and consist of multi asset class structures. Improved governance should be an objective in any reform. On passive management, the SSAB supports a 'comply or explain' approach that both leaves room for active management but also provides for intervention when performance does not reach the required standards."

3.14 Similarly, the National Association of Pension Funds commented that the LGPS should not be treated as a "homogenous whole when it is comprised of 89 different funds, some of which already perform extremely well". The focus should be on individual fund performance within the LGPS with regulatory intervention to bring poorly-performing funds up to standard. Instead of making the use of passive instruments mandatory, a 'comply or explain' approach should be adopted and regularly reviewed by various external parties. The body also said that investment in one type of CIV should not be mandatory, and that the funds should instead have the flexibility to look at alternative ways of co-investing.

Budget 2014 – Potential impact upon LGPS & Lothian Pension Fund

3.15 The government published its response to its consultation on *'Freedom and choice in pensions'* on 21 July 2014. This concerns the changes announced in the March 2014 budget to allow individuals, from the age of 55 with a defined contribution (DC) pension to access their entire pension flexibly if they wish, from April 2015.

3.16 An issue of particular importance to public service pension schemes including the LGPS has been the proposal by the government to remove the option for members to transfer their benefits from a defined benefit (DB) scheme into a DC scheme. Indeed, the current version of the Pension Schemes Bill 2014, which had its first reading in the House of Commons on 26 June 2014, already includes draft provisions enabling HM Treasury to issue regulations preventing such transfers from public service pension schemes.

3.17 The government has now confirmed that it intends to remove the option to transfer to a DC scheme only from the unfunded public service pension schemes (except in very limited circumstances). However it will continue to allow transfers from funded public service pensions (including the LGPS) to DC schemes. The government intends to work with stakeholders over the summer to ensure appropriate safeguards are introduced to the LGPS which give due consideration to the interests of both scheme members and the taxpayer.

3.18 The government states that these safeguards will be similar to those that are proposed for DB/DC transfers in the private sector where:

- there will be a statutory requirement on the transferring DB scheme for all individuals who are considering transferring out to take advice, from a professional financial adviser who is independent from the DB scheme and authorised by the Financial Conduct Authority (FAC), before transferring; and
- the government intends to ensure that there is new guidance for trustees to make them more aware of the powers that they already have available to ask the Pensions Regulator for a longer period in which to make the transfer, and to reduce transfer values offered if the scheme funding position warrants that.

3.19 It is therefore likely that the government will consider safeguards similar to the two set out above within the LGPS.

3.20 Should a significant number of members chose to transfer their benefits out of the Lothian Pension Fund to take advantage of new flexibility, this could have cash-flow, investment and funding implications. These matters were highlighted in the joint LGA / LGPC response to the "Freedom and Choice in Pensions" consultation, dated 10 June 2014. A link to the LGA/LGPC submission is provided later in this report.

Recovery of Public Sector Exit Payments

3.21 In May 2014, the Government announced that the Small Business, Enterprise and Employment Bill will include legislative provisions to ensure exit payments are recovered when high earners return to the same part of the public sector within twelve months of leaving. Exit payments include redundancy and compensation payments made on termination of employment. A consultation paper has now been issued.

Law Commission report on "Fiduciary duties of investment intermediaries"

3.22 The Law Commission published a report explaining and setting out its recommendations to the UK Government on 1 July 2014. Its primary aim was to explain the nature of fiduciary and other duties to act in the best interests of savers, and to describe how these duties apply to investment intermediaries. The report concluded that trustees should take into account factors which are financially material to the performance of an investment. Where trustees think ethical or environmental, social or governance (ESG) issues are financially material they should take them into account. However, whilst the pursuit of a financial return should be the predominant concern of pension trustees, the law is sufficiently flexible to allow other, subordinate, concerns to be taken into account. It concluded that the law permits trustees to make investment decisions that are based on non-financial factors, provided that:

- they have good reason to think that scheme members share the concern; and
- there is no risk of significant financial detriment to the fund.

3.23 The report recommended that the Pensions Regulator consider how the guidance could be given greater exposure and authority. In the longer term, the recommendation of the Law Commission was that the Pensions Regulator should include this guidance in one of its codes of practice.
The report did not recommend statutory reform of the general law of fiduciary duties, or its codification. However, it did recommend some changes to the Occupational Pension Schemes (Investment) Regulations 2005 and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

3.24 In terms of these specific regulations, the report "raised concerns about the failure to transpose article 18(1) of the IORP Directive into the regulations governing the Local Government Pension Scheme (LGPS). As a consequence, there is no legislative equivalent for the LGPS to the requirements imposed by regulation 4 of the Investment Regulations. In particular, there is no requirement in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 for the scheme assets to be invested in "the best interests of members and beneficiaries". Whilst it is unclear what effect this has in practice, given that the Directive may be directly applicable and that some administering authorities regard themselves as "quasi-trustees", ... this uncertainty is undesirable. It should be put beyond doubt that the requirements of article 18(1) of the IORP Directive apply to the LGPS."

3.25 Also, the report commented on the criticisms made by Professor John Kay, in his review of UK equity markets and long-term decision making, published in July 2012, of short-term appointments, coupled with quarterly reviews. "It may therefore be helpful to review the requirements under regulation 9 that the administering authority must be able to terminate the appointment by not more than one month's notice and that the investment manager must report to the administering authority at least once every three months."

3.26 The Law Commission also considered other areas of the investment chain, looking in particular at investment consultants, stock lending and intermediated shareholding. It decided not to recommend a review of the regulation of investment consultants. However, it did suggest that:

- stock lending fees should be considered alongside the review of the default fund charge cap in 2017; and
- the Government should review the current operation of the system of intermediated shareholding, with a view to taking the lead in negotiating solutions at a European or international level.

Measures of Success

4.1 This report is purely advisory at this stage.

Financial impact

5.1 There are no financial implications arising directly from this report. Changes to the LGPS in Scotland, however, will have financial consequences for Lothian Pension Fund and Lothian Buses Pension Fund, participating employers and members. The option for members to take transfers from the pension funds to DC arrangements could impact on cash-flow and funding. These will be addressed in future reports to the Pensions Committee.

Risk, policy, compliance and governance impact

6.1 From a governance perspective, this report is purely advisory at this stage. In due course, a revised governance structure for the LGPS in Scotland will require changes to be made by the City of Edinburgh Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

6.2 There is a risk that taxation changes for defined contribution pensions schemes may have an impact on the cash-flow, investment and funding of the pension funds.

Equalities impact

7.1 There are no adverse equalities impacts arising from this report. Changes to the design of the LGPS are subject to Equality Impact Assessment by the Scottish Government.

Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report. The Public Service Pensions Act 2013 aims to make pensions more sustainable.

Consultation and engagement

9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds. Lothian Pension Fund is committed, on an ongoing basis, to keeping its employers and members fully informed of all the key developments on reform of the LGPS in Scotland. Consultation will take place at appropriate times.

Background reading / external references

Heads of Agreement on the new Local Government Pension Scheme in Scotland were published on 12 December 2013. These are available on the Lothian Pension Fund web-site through the following link:

http://www.sppa.gov.uk/Documents/Local%20Government/Useful%20Resources/Consultations/2014/LGPS_Heads%20of%20Agreement_231213.pdf

The LGPS (Scotland) Regulations 2014 [SSI 2014/164] can be viewed at http://www.legislation.gov.uk/ssi/2014/164/contents/made, with the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 (SSI 2014/233) available at the following link http://www.legislation.gov.uk/id/ssi/2014/233

Similarly, please see links to the consultation on proposals for governance in the LGPS in Scotland, together with the response from this Council.

The web-site which provides information to members and employers on the new LGPS in Scotland is www.scotlgps2015.org.

Selected responses to the consultation on opportunities for collaboration, cost savings and efficiencies for the LGPS in England and Wales are provided as follows:

Shadow Scheme Advisory Board (LGPS):
http://www.lgpsboard.org/images/CFE/SSAB%20response%20to%20structural%20reform%20consultation%20final

LGA:
http://www.lgpsregs.org/images/Drafts/LGA-Opp-CCSEConsResponse.pdf

Hymans Robertson LLP:
DCLG consultation submission

The LGA/LGPC's response to HM Treasury's "Freedom and Choice in Pensions" consultation (announced as part of the 2014 Budget) can be found at http://www.lgpsregs.org/images/Drafts/LGA-FCPConsResponse.pdf

The government's published its full response to its consultation on 'Freedom and choice in pensions' on 21 July 2014.

The Government's consultation paper on the recovery of public sector exit payments is available on http://www.gov.uk/government/consultations/recovery-of-public-sector-exit-payments/recovery-of-public-sector-exit-payments

The Law Commission's report on the fiduciary duties of investment intermediaries can be viewed at http://lawcommission.justice.gov.uk/areas/fiduciary_duties.htm

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Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	
Appendices	Scottish LGPS Heads of Agreement on Governance

Scottish Local Government Pension Scheme

Governance – Heads of Agreement

Introduction

The UK Public Service Pensions Act sets out new governance requirements for pension funds across the UK, implementing the Hutton recommendations. The SPPA has recently consulted on new arrangements and SLOGPAG has considered the responses and the views of key stakeholders. This paper sets out the Heads of Agreement for a new governance structure in Scotland.

It is recognised that governance arrangements will be subject to on-going review to reflect changes in, or interpretation of, legislation and best practice. For example, interpretation of the current legal requirements of the Institutions for Occupational Retirement Provision (IORP) Directive and any changes as a result of the new proposed IORP Directive. The Heads of Agreement for the new scheme (agreed in December 2013) also sets out the process for a wider review of structures which could impact future governance arrangements.

It is also recognised that these arrangements will be subject to the views and agreement of Scottish Ministers.

Scheme Advisory Board

The Scheme Advisory Board is the body responsible for providing advice to the Responsible Authority (Scottish Ministers), on the desirability of changes to the scheme. The Scheme Advisory Board also provides advice to the Scheme Managers and Pension Boards in relation to the effective and efficient administration and management of the scheme.

The new scheme advisory board is not a big change in Scotland as we have had a similar body in SLOGPAG for many years. The main elements of the Scheme Advisory Board should be as follows:

- It will be a bipartite body with representatives from local government employers and trade unions. The Scottish Government will be present as observers.
- There will be 7 employer and 7 trade union representatives. Substitute representatives will be available and will have undergone the requisite training and development to inform their role.
- The Chair will be rotated on an annual basis or an independent Chair may be appointed by Scottish Ministers.
- The secretariat will be provided by two Joint Secretaries, appointed from COSLA and the Trade Unions.
- Advisors e.g. Directors of Finance will also attend the Board but will not have membership status.
- Observers e.g. Scottish Government will also attend the Board but will not have membership status.

Pension Boards

Pension Boards will be established covering each fund in Scotland and will be the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator.

The consultation process indicated a difference between the employer and trade union views on having pension boards in addition to the current structure or merging them into one board. A hybrid solution has therefore been agreed that would retain the pension committee of the administering authority with membership appointed under current arrangements and responsibility for fund management.

While the roles and function of pension committees and pensions boards will be set out in the regulations, the normal practice would be that both bodies would meet at the same time to consider the same agenda, with the Chair of the pension committee chairing the concurrent meeting. This innovation will result in a positive and proactive partnership culture where in practice the two bodies act as one.

New pension boards would also be established as follows:

- Membership would consist of equal numbers of trade union representatives and employers drawn from other councils and scheduled or admitted bodies in membership of that fund.
- As a minimum there will be 4 trade union and 4 employer representatives with the expectation that larger funds will require greater numbers. Numbers from organisations on either side will broadly reflect respective membership in the scheme.
- The Chair will be rotated on an annual basis.
- The secretariat will be provided jointly from the pension fund and the local trade union representatives.
- Advisors and observers will also attend the Board but will not have membership status

There will be a model constitution setting out the administrative arrangements for pension boards. Representatives of employers and trade unions will define the local parameters in addition to the model constitution. If there is difficulty in agreeing those local parameters, the Scheme Advisory Board can act as a point of resolution.

The pension board will determine the areas they wish to consider including, amongst others:

- Reports produced for the pensions committee
- Requisition reports from the scheme managers on any aspect of the fund
- Monitor investments and the investment principles/strategy/guidance
- The fund annual report
- External voting and engagement provisions
- Fund administrative performance
- Actuarial reports and valuations
- Funding policy
- Any other matters that the pensions board deem appropriate

If the pension committee and pension board cannot reach joint agreement on any matter the process for resolving any differences between the two bodies will be as follows. Whilst this process is undertaken the decision of the pension committee is still competent.

In the first instance, if at least half of the members agree, then the pension board can refer back a decision of the pensions committee for further consideration if any of the following grounds are met:

- That there is evidence or information which it is considered needs re-evaluating or new evidence or data which the pensions Committee did not access or was not aware of at the point of decision making and which is considered material to the decision taken;
- That the decision of the pensions Committee could be considered illegal or contrary to regulations;
- That the decision of the pensions Committee is contrary to a relevant Code of Practice published by the Pensions Regulator; or

- That the decision is not in the interest of the continued financial viability of the Scheme or is against the principles of proper and responsible administration of the Scheme

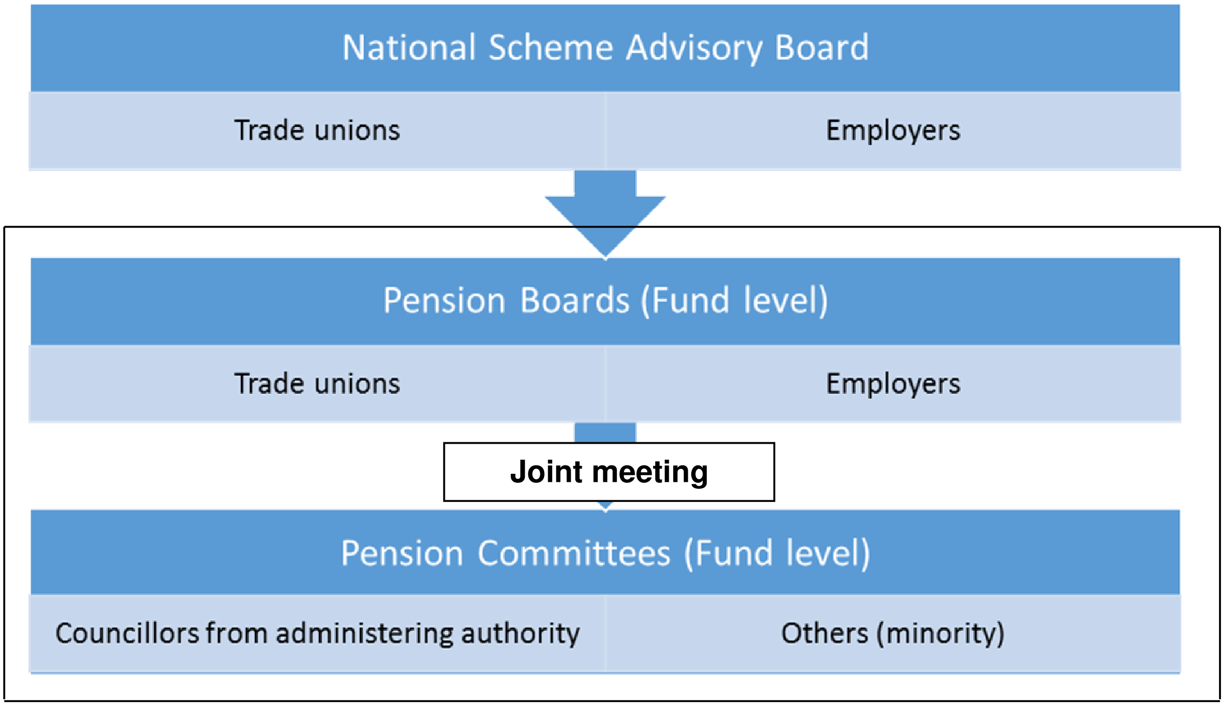
If there is no agreement after the matter has been referred back to the pensions Committee, then the difference in view between the Pension Board and the Pension Committee should be published in the form of a joint secretarial report on the fund website and included in the fund annual report.

It may then be appropriate for the Scheme Advisory Board to consider and take a view on the matter and, if considered appropriate, to provide advice to the Scheme Manager or the pension board in relation to the matter.

There will be an agreed training programme for all members of pension committees and pension boards.

All administration costs will be met by the relevant fund.

The structure is shown diagrammatically below.



COSLA / TU Joint Draft
May 2014