Agenda Item No: **7**

CITY OF WOLVERHAMPTON COUNCIL

Pensions Committee

23 September 2015

Report title	Local Government Pension Scheme (LGPS) Reform Update 2015	
Originating service	Pension services	
Accountable employee(s)	Rachel Howe Tel Email	Head of Governance 01902 552091 Rachel.howe@wolverhampton.gov.uk
Report to be/has been considered by	Geik Drever Tel Email	Strategic Director of Pensions 01902 552020 Geik.drever@wolverhampton.gov.uk

---

Recommendations for action or decision:

The Committee is recommended to:-

a) Endorse discussions with other funds on pooling for investments and contribute to costs of any data collection and project development

Recommendations for noting:

The Committee is asked to:-

a) Note the contents of the report

1.0 Purpose

1.1 To provide Committee with an update on the reforms of the Local Government Pension Schemes over the last 12 months from Central Government and those anticipated in the next 6 – 12 months.

2.0 Background

2.1 The Public Service Pension Commission, headed by Lord Hutton, made a number of recommendations about the future design of public service pension schemes. As a result, the Government is looking to reform the LGPS, along with other public service schemes, so that the cost of providing these pensions is affordable, not just now but in the decades to come.

2.2 The Government's position is that public service pension schemes, including the LGPS, will remain among the very best available, providing a defined benefit pension for all employees.

2.3 This report discusses some of the key themes and considerations facing LGPS funds as we strive to meet the Government's requirement to be affordable, cost effective and most importantly sustainable.

3.0 The Scheme Advisory Board (SAB)

3.1 Committee will recall that as part of the Governance Reforms, the National Scheme Advisory Board was formally created on 1 April 2015, it having operated in shadow form throughout 2014.

3.2 The purpose of the SAB is to be both reactive and proactive in encouraging best practice throughout LGPS funds, increasing transparency and coordinating best practice. The SAB also provides advice to the Secretary of State on the desirability of changes to the scheme while also assisting schemes themselves on their effective and efficient management and administration.

3.3 The interim SAB consists of 21 seats, The Chair, 6 Employer representatives, 6 Member (Trade Union) representatives, 5 Advisors, 3 Observers

3.4 Currently, the Secretary of State has not made a formal appointment to the Chair of the National Board and it currently sits in transition pending formal appointments.

3.4 SAB Workplan

3.4.1 To focus its work over the next 12 months, the SAB has created a work program focussing on themes it believes are a priority for the LGPS in the coming year and include

- Deficit Management
- Cost control

- Knowledge and Understanding guidance for Trustees and Local Pension Board Members
- Options for separation
- Value for money guidance
- Scheme annual report
- Engagement Guidance
- Guidance on the Pension Regulator's Code of Practice.

A copy of the SAB's workplan is attached at Appendix 1.

3.4.2 As reported to Committee last year, the Fund was anticipating contributing to the budget of the SAB as it was believed the SAB would be funded by funds in the Public Service Schemes. This figure has not (at the time of writing) been confirmed by the SAB but initial figures suggest the cost to WMPF is around £35,000.

3.5 SAB Performance and Benchmarking

3.5.1 As part of the work of the SAB, earlier in the year it published proposals for benchmarking funds in the LGPS for performance and efficiency. Committee will recall the training on the proposed Key Performance Indicators (KPIs) drafted by the SAB which are intended to be used to benchmark funds in ensuring effective governance and administration.

3.5.2 Since that time WMPF have been engaged with a pilot scheme. The pilot gave funds the opportunity to help develop the KPIs and in particular assess their funds against the examples of best practice and concern for each KPI, inform on the effort, time and cost consumed in carrying out the assessment and provide general feedback before their implementation.

3.5.3 Following this feedback, the SAB have redrafted the KPI template and guidance, providing more clarity around the KPI definitions. This will be issued to all funds in early September for completion by 31st October 2015.

3.5.4 The SAB will review the outcome of the pilot in early 2016 and will recommend to DCLG that reference to SAB guidance on annual reporting and KPIs are included in LGPS regulations/scheme guidance and/or as part of 31st March 2016 valuation process. They will then be issued in April 2016 and from December 2016 used as tool to assess and support funds accordingly.

3.6 LGPS options for separation

3.6.1 As detailed above, one area of work for the SAB over the coming months is to consider options for separation in the LGPS from lead authorities. The SAB have appointed KPMG to look into these proposals.

3.6.2 As it stands within England and Wales the Local Government Pension Scheme is one Scheme administered by different authorities who each operate a Fund within this larger Scheme. The size of those individual funds vary, as do their operational structure (which in part was the reason for the governance reforms earlier this year). Some share services with other administering authorities while some, which may be quite small in comparison, delegate their responsibilities under S101 of the Local Government Act 1972.

3.6.3 The SAB is keen to gather opinion on how the LGPS should be structured with the continued intention to improve governance and efficiency while ensuring all funds operate on a comparable basis.

3.6.4 Option 1 – Stronger role for the Section 151 Officer within a district entity of a host authority

Primary recommendations

- Separation of financial statements and audit arrangements
- Pension fund specific annual governance statement
- Specific delegations or require a senior officer to lead the function
- Group the responsibility for all LGPS related activity within one function

Currently, regulations require that the pension fund accounts are incorporated into the administering authority's accounts. This option proposes that the two become distinct documents in their own right necessitating the need for separate operating budgets and audit requirements. It would also require a separate annual governance statement confirming the effectiveness of the fund's internal controls.

Under this option, there would be a requirement to either move the pension fund responsibilities from the administering authority's S151 officer to another senior officer who would hold that specific function or to create a dedicated senior officer to take on the pension fund responsibilities, thereby removing the potential for conflict.

In doing so, that officer would then be responsible for one organisation unit grouping all elements of pension fund activity within it. WMPF operates under this structure at present, with responsibility resting under the Strategic Director of Pensions and with the Section 151 (Director of Finance WCC) and monitoring officer (Director of Governance WCC) assisting.

3.6.5 Option 2 – Joint Committee of two or more administering authorities

Primary recommendations

- Delegation of full scheme manager function and all decision making to a section 102(5) joint committee.
- Employment of staff and contractual issues dealt with through lead authority of wholly owned company
- Ownership of assets unchanged
- Consideration to be given to enshrining the structure in legislation in the form of a combined authority.

The current structure we have at WMPF with the West Midlands Integrated Transport Authority Pension Fund (ITA) is one example of how Option Two might operate.

Committee will recall at its March meeting Trustee's received a request from ITA to accept a delegation under S101 of the Local Government Act 1972 for the management and administration of the ITA fund and to act as the decision making body for all matters relevant to that work. Under this delegation each authority, WMPF and ITA remain their own legal body holding assets, and liabilities, in their own names.

Since this delegation has been accepted, officers at the WMPF have drafted and issued a letter to the Treasurer Officer at ITA confirming our role going forward. A copy of that letter is attached as Appendix 2.

The consideration provided under Option 2 is to then extend this arrangement further by creating the joint committee as its own legal entity through the creation of a combined authority or jointly owned company. This would create the pension fund as its own legal entity whereas currently it is not thereby requiring all assets to be held in the name of the administering authority. As a legal entity, the Fund could then employ its own staff and enter its own contracts taking responsibility for all assets and liabilities, but still subject to the governing rules of local authorities. This may be useful when considering pooling investment opportunities.

3.6.6 Option 3 – LGPS complete separation of the pension fund from the host authority

Primary recommendations

- Remove decision making from elected members
- DCLG or Treasury to create single purpose pension boards.

This option proposes that Central Government create a department to take over the function of pensions thereby removing the need for local authorities to take on the role. The suggestion is that the department could still exist in the public sector but take on a corporate pension structure designed to fully comply with the IORP Directive and completely separate from the admin authority.

In doing so they would take on local authority staff currently dedicated to pensions within their administering authority.
Alternatively, rather than create a single pension authority, this option also proposes to remove potential conflict between the admin authority and the pension fund by placing the fund in a separate body with its own duties aligned solely to the benefit of its members.

3.6.7 The outcome of this study will be going to SAB on 21 September 2015 and a verbal update will be provided to committee at the meeting.

4.0 LGPS Pooled Investment

4.1 In the summer budget (on 8 July 2015), the Chancellor announced that 'the government will work with the LGPS administering authorities to ensure that they pool investments to significantly reduce costs, while maintaining overall investment performance. The Government will invite local authorities to come forward with their own proposals to meet common criteria for delivering savings. A consultation to be published later this year will set out these detailed criteria as well as backstop legislation which will ensure that those administering authorities that do not come forward with sufficiently ambitious proposals are required to pool investments.' (Page 78 of the red book).

4.2 The announcement represents the latest phase in the work to deliver savings from LGPS investments, building on May 2014's consultation ' Opportunities for collaboration, cost savings and efficiencies', the Fund's response to which was agreed by the Pensions Committee in June 2014 (agenda item 20). The then coalition government did not revert with any proposals following that consultation.

4.3 It is expected that the government will publish the common criteria in the autumn. These are expected to focus on the size/scale of investment pools, costs and governance arrangements. It is expected also that there will be a consultation on the LGPS Investment Regulations then. The LGPS will be given the opportunity to put forward its own proposals. The term 'pooling' appears to be deliberately broad and could involve initiatives such as joint procurement, collective investment vehicles and other forms of collaboration.

4.4 The government is likely to welcome building on existing collaboration work undertaken by LGPS funds, for example the Common Investment Vehicle (CIV) set up by the London LGPS funds and joint procurement initiatives. There appears to be an assumption that scale - leading to the creation of small number of large pools – can deliver significant benefits.

4.5 WMPF is supportive of continued collaboration with other LGPS funds, building on initiatives such as Investing for Growth, the National LGPS Frameworks and the Pensions Infrastructure Platform (PIP). As one of a number of LGPS funds with an established internal investment management capability, it believes that in-house investment management should continue to have a crucial role to play in delivering good investment performance cost effectively.

4.6 Discussions are taking place at officer level with other LGPS funds to determine potential solutions. Several other LGPS funds also have successful in-house investment capabilities and there should be scope to build on these through collaboration.

4.7 Committee is therefore requested to endorse these discussions and also to contribute to costs of any data collection and project development on these solutions with other funds.

4.8 It is not envisaged that changes will be made to the powers of local section 101 committees, which will continue to be responsible for the setting of investment and funding strategy and determining the asset allocation for the fund.

4.9 The Pensions Committee will be updated once the government publishes its consultation and criteria. Its approval will be sought to any proposals in relation to WMPF and the pooling of LGPS investments.

5.0 Deficit Management

5.1 The Scheme Advisory Board (SAB) was tasked with looking at innovative proposals for managing scheme deficits. On 23 June 2015 SAB sent a letter to DCLG outlining five recommended changes to scheme regulations, aimed at improving the management of scheme deficits. The five changes would bring:

- Calculation of funding levels by fund actuaries on a standardised basis by 30 September in each triennial valuation year;
- Set and publish assumptions to be used for standardised funding calculations by SAB by 31 March in each triennial valuation year;
- Additional disclosure and fund actuary certification of aggregate and individual employer contribution rates (split by future and deficit contributions, with deficit contributions expressed as a cash sum);
- Consultation on setting and calculation of minimum employer contribution rates; and
- Additional disclosure of deficit recovery plan methodology in funding strategy statements.

5.2 The SAB working group held a further “blue sky thinking” meeting at the end of July 2015. The Trustees will be updated on any material developments from this group as and when they become available.

6.0 Summer Budget Changes on Pension Taxation

6.1 In his 8 July 2015 budget, the Chancellor announced a further reduction in the Annual Allowance for higher earners from April 2016 and a broader consultation on pension tax relief.

<u>Annual Allowance reduction for “high earners”</u>

6.2 The Annual Allowance is the maximum amount an individual’s pension savings can grow tax-free in any one year. Pension savings above this level are taxed as income. The Annual Allowance was set at £40,000 per annum with effect from the 2014/15 tax year. From April 2016 it will be tapered down to £10,000 for those with “earnings” between £150,000 and £210,000 and set at £10,000 for those with earnings over £210,000.

6.3 “Earnings” for the purpose of this test (the earnings test) *include* the value of employer funded pension benefits built up over the year. The earnings test (and tapered Annual Allowance) will only apply to those with taxable income (excluding pensions) above

£110,000. In practice, those building up standard LGPS benefits with taxable income over £170,000 are likely to see their Annual Allowance reduce to £10,000. All else being equal, the £30,000 fall in allowance for these members will generate additional individual pension tax charges of £13,500 per annum.

6.4 The tapering removes £1 of Annual Allowance for every £2 earnings exceeds £150,000. For example a member with "earnings" (taxable income *plus* pension) over the year of £155,000 will have an Annual Allowance of £37,500; a member with earnings of £180,000 will have an Annual Allowance of £25,000.

6.5 As the tapering only applies when taxable income (excluding pensions) exceeds £110,000, more moderate earners who experience "one-off" increases in the value of their pension in a single year (for example due to promotion) should be protected from the change. Overall, however, the change is expected to increase the number of members who incur pension tax charges at the point pension is earned.

6.6 As the Annual Allowance for the tax year will depend on earnings in that tax year planning to avoid the incidence of pension tax will be more difficult as there will be some uncertainty as to an individual's Annual Allowance until the end of the tax year.

6.7 To facilitate this change, the LGPS Pension Input Period (PIP) will change from 31 March to align with tax years from 2016/17, with transitional arrangements for 2015/16. Under the transitional arrangements, members will have an Annual Allowance of £80,000 for 31 March 2015 to 5 April 2016 with a limit of £40,000 over the period 9 July 2015 to 5 April 2016 (before allowing for any "carry forward" in unused allowance from the three previous years).

6.8 In the LGPS members can elect to pay any pension tax charges incurred through "Scheme Pays". Under this arrangement the Fund pays tax on behalf of the member and Fund benefits are reduced accordingly.

6.9 The Fund will need to collate additional information (such as total taxable income over the prior tax year) to calculate members' Annual Allowance and assess whether or not pension earned over the year has exceeded this limit. It is expected that the changes will impact a limited number of members in practice but those affected will need to review their own individual tax position and assess the options available to them to mitigate the potential increase in personal tax charges.

6.10 Following completion of the 2015 annual return and benefit statement exercise, the Fund will review membership records to identify those potentially affected by the change and liaise with employers accordingly. The Fund's member relationship officers are already talking to employers and employees about the change and are available to discuss the changes with individuals and small groups, as required.

Consultation on pension tax relief

6.11 The government has launched a “big picture” review of pension tax relief called “strengthening the incentive to save”. The consultation encourages an open discussion on reform to the current system, inviting views on a full range of options from fundamental reform (for example, moving to a “Taxed-Exempt-Exempt” system similar to ISAs) to further changes to the current system (through the Lifetime and Annual Allowances). The context for consultation is increasing life expectancy and a trend towards defined contribution pension savings (both challenging the adequacy of pension saving) together with an evolving pension and savings industry.

6.12 The aim is to ensure all individuals have a simple and transparent incentive to save (and are personally responsible for having) sufficient income for retirement whilst ensuring the support given through the tax system is sustainable over the longer term. The current system is estimated to have “cost” almost £50 billion in tax/NI relief over 2013/14.

6.13 The government acknowledges that the outcome could be “no change”, not least because of the issues change would bring (ranging from macro-economic to implementation costs) and the competing nature of objectives. The consultation will close on 30 September 2015.

6.14 The potential implications and impact on the members and the Fund are wide-ranging. Any material change to the current system is likely to affect how members save for retirement and impact on the administration of the Fund. The consultation could lead to greater transparency of the value of pension tax relief and a simpler (e.g. flat-rate) approach to taxation. It could also lead to greater complexity in the current system which is getting increasingly harder for members to understand and manage.

7.0 Public Sector Exit Payments cap of £95,000

7.1 On 31 July 2015 HM Treasury announced a four week consultation on capping exit payments for Public Sector workers. The proposed cap of £95,000 is to include employer contributions required to meet the cost of early access to pension benefits.

7.2 In the LGPS, members over age 55 currently have an entitlement to access unreduced benefits when they are made redundant or leave on grounds of business efficiency. Under the consultation, members would still be able to access benefits but only to the extent they can do so without breaching the cap (or in full if the member meets the additional cost of early access). It is unclear at this stage how the cap would operate in practice but changes will need to be made to the LGPS regulations to reflect any cap.

7.3 The consultation also notes that the Government is considering further reforms to employer funded early retirement promises.

7.4 A briefing note, attached as Appendix 3, outlining the key points from the consultation and potential issues (including wider employment related issues) associated with the proposal was issued to employers in August 2015. Not all employers will be subject to the cap but those who are not are expected to formulate their own payment cap. The Fund shared this note (and comments on the operational aspects from a Fund perspective) with LGA for inclusion in their formal response.

7.5 The cap could be introduced as early as April 2016. The Trustees will be updated on the outcome of the consultation and any proposed amendments to LGPS regulations as details of these emerge.

8.0 Financial implications

8.1 The Fund has made provision in its 2015/16 operating budget for the contribution to the Scheme Advisory Board. The other developments set out in this report may have financial implications for the Fund in the longer term, but it is too soon to quantify these.

8.2 Contributions relating to development of proposals and project development is expected to be in the region of £10,000 and can be funded from the service development budget.

9.0 Legal implications

9.1 At this stage the information contained within this report is for noting and no decision is required to be made. All legal implications are noted within the report.

10.0 Equalities implications

10.1 The report notes changes to the scheme as recommended or created by Government whose policies would have undertaken their own assessment prior to circulation.

11.0 Schedule of background papers

11.1 Report to March Pensions Committee “Delegation from ITA”

http://wolverhampton.moderngov.co.uk/documents/s9109/Governance%20Reform%202014%20Delegation%20of%20the%20Integrated%20Transport%20Authority.pdf

12.0 Appendices

12.1 Appendix 1
National Scheme Advisory Board workplan

12.2 Appendix 2
Letter to ITA regarding role of WMPF Pension Committee under delegation.

12.3 Appendix 3
Copy briefing note circulated to employers on Public Sector Exit Payments