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The Nottinghamshire Local Pension Board

LGPS Update

A paper by the Advisor to the Pension Board
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Introduction

This paper informs the Pension Board of some developments relating to the Local Government Pension Scheme (LGPS) since the last Advisor's update. The issues covered are:

1. Creation of Department for Levelling Up, Housing and Communities (DLUHC) and appointment of new Minister responsible for the LGPS
2. Levelling Up White Paper and the LGPS in England & Wales
3. LGPS Consultations and responses
4. Cost Control mechanism
5. Review of 2019 Actuarial Valuations by the Government Actuary

The paper approaches the above issues in the context of the LGPS in England & Wales as a whole rather than in terms of the Nottinghamshire Fund in particular.

1. Creation of the Department for Levelling Up, Housing and Communities (DLUHC) and appointment of new Minister responsible for the LGPS

In mid-September 2021, the Prime Minister reorganised Government. This reorganisation included the creation of the **Department for Levelling Up, Housing and Communities (DLUHC)** to replace the Ministry of Housing Communities and Local Government (MHCLG). The Rt Hon Michael Gove MP was appointed Secretary of State at the DLUHC in succession to Rt Hon Robert Jenrick MP who had been Secretary of State at MHCLG since July 2019. Luke Hall MP who had been the Minister at the MHCLG directly responsible for the LGPS since September 2020 left the Government in the September 2021 reorganisation. Other Ministerial appointments within the DLUHC were also made in mid-September 2021 but details of Ministerial portfolios were not immediately announced.

On 6 October 2021, the LGPS Scheme Advisory Board for England and Wales (SAB) stated on its website that *"We understand that Kemi Badenoch MP will be the new minister for Local Government and will therefore take up responsibility for the LGPS. We would expect that the change of minister would lead to some delays in the current workstream…"*

The responsibilities of Kemi Badenoch MP whose official title is Minister of State (Minister Levelling Up Communities) are extensive and extend far beyond the LGPS. Ms Badenoch's role includes Local Government policy, finance, and improvement in England; Supporting Families programme; Integrated Communities (including Faith engagement, English Language); Elections policy (including leading on the Elections Bill in the House of Commons).

2. Levelling Up White Paper and the LGPS in England & Wales

On 2 February 2022, the DLUHC (Department for Levelling Up Housing and Communities) issued a White Paper ***"Levelling Up the United Kingdom."*** The White Paper sets out the Government's ambition and plans in terms of "levelling up." To quote from the Prime Minister's foreword *"…To take the radical steps needed to make us more prosperous and more united by tackling the regional and local inequalities that unfairly hold back communities…this White Paper describes... The practical steps this government will take in everything from education to art to investment that will make this a better, fairer country for us all."*

The White Paper is very detailed and lengthy (the main document is 332 pages cover to cover and the Technical Annexe 54 pages). The Government sets out twelve ***"Levelling up Missions"*** which are summarised on pages 120 and 121. The Policy Programme to achieve levelling up is set out in detail in Chapter 3 (pages 159-243). Associated with the Mission "*Living Standards"* there is reference to the LGPS on pages 162 and 163 of the White Paper.

One paragraph on pages 162/163 and three paragraphs on page 163 include reference to the LGPS. The paragraph on pages 162/163 *states "There is huge potential for institutional investment to support levelling up, across infrastructure, housing, regeneration and SME finance. Institutional investors currently hold UK pension assets of over £3.5tn. Within that, the Local Government Pension Scheme (LGPS) has total investments of over £330bn, making it the largest pension scheme in the UK. Only a tiny fraction of these funds are currently allocated to local projects. If all LGPS funds were to allocate 5% to local investing, this would unlock £16bn in new investment."*

Consequently, on page 163 the White Paper includes a paragraph which states *"Infrastructure investment by the LGPS has grown from under £1bn in 2016 to £21bn in 2021. To build on this established capacity and expertise, and ensure that all LGPS funds play their full part, the UK Government is asking LGPS funds, working with the LGPS asset pools, to publish plans for increasing local investment, including setting an ambition of up to 5% of assets invested in projects which support local areas."*

On 2 February 2022, the day the White Paper was issued, the SAB posted a statement on its website. Given both the SAB has close links/contacts to/with the DLUHC and the actual content of the statement it should be carefully noted. The full text reads: *"Today the government published the Levelling Up whitepaper which includes references to LGPS funds having plans for up to 5% of assets to be allocated to projects which support local areas. We understand that in this context local refers to UK rather than local to a particular fund and that there will be no mandation beyond the requirement to have a plan. Further details will emerge over the period up to an expected summer consultation which we understand will also include the outstanding climate risk and reporting regulations and the pooling guidance."*

Therefore, in essence the White Paper merely contains an exhortation to the LGPS to invest in UK infrastructure including housing. The wording of the Whitepaper makes no suggestion of actually requiring LGPS Funds to increase *"local investment."* Rather the Whitepaper merely states *"… UK Government is asking **LGPS funds, working with the LGPS asset pools, to publish plans for increasing local investment**, including setting an ambition of up to 5% of assets invested in projects which support local areas."* This approach which requires only a plan which relates to the UK as a whole is in reality the only practical approach Government can take. Any attempt to direct mandatory investment would likely be contrary to Fiduciary Duty and public law duties and would, almost certainly, result in legal challenge(s) potentially including an application for Judicial review.

The wording of the White Paper is merely stating that LGPS Funds be asked to publish plans to increase investment in infrastructure and housing across the UK. LGPS Strategic Asset Allocations are, however, not driven by government exhortations but by LGPS funding/investment requirements influenced by factors such as funding levels, actuarial assumptions, risk/diversification, inflation and cashflow, existing allocations etc.

Recent years have, however, seen a trend towards greater LGPS investment in infrastructure (but not necessarily/always UK infrastructure) and housing. This will likely continue for strategic investment reasons rather than because of Government exhortation. In summary the White Paper, in itself, may therefore have little overall impact on the LGPS in England & Wales.

3. LGPS Consultations and Government responses

There has been a lack of Consultations and Government responses relating to the LGPS since the Update presented to the September 2021 meeting of the Board. Not only has there been no statement from Government in relation to Consultations in respect of the major investment issues of TCFD (Task Force on Climate Related Financial Disclosures) reporting by the LGPS, and Investment Pooling but there has been silence on other significant outstanding issues.

These include the Good Governance in the LGPS project proposals which were submitted to Government by the Scheme Advisory Board in early 2021; the response on some matters (proposed lengthening of the Actuarial Valuation cycle from 3 to 4 years and no longer requiring some education employers to offer LGPS membership to employees) in the Consultation "Changes to the local valuation cycle and the management of employer risk" which closed on 31 July 2019; and the Consultation on "Fair Deal – Strengthening pension protection" which closed on 4 April 2019 and in respect of which a response has still not been published.

The expected Consultation to amend the LGPS Regulations to apply TCFD reporting to the LGPS is still awaited. As was stated in the September 2021 Update the Department for Work and Pensions (DWP) has consulted upon and issued final Regulations on TCFD reporting by private sector pension schemes. These do not apply to the LGPS and therefore it was expected that before the end of 2021 the DLUHC would issue a Consultation to amend the LGPS Regulations to apply TCFD reporting to individual LGPS Funds.

The Consultation on an updated framework for LGPS Investment Pooling remains outstanding. The (then) MHCLG issued a Consultation in January 2019 but subsequently withdrew this. In November 2020, the Government stated in writing (in "The Balance Sheet Review Report" issued by HM Treasury) that it would *"consult"* in 2021 *"on next steps"* to implement *"a strengthened framework for LGPS investment and pooling"* but this did not occur. Therefore, the mandate for Investment Pooling within the actual LGPS Regulations remains limited to one statement in the LGPS (Management and Investment of Funds) Regulations 2016. This is, that the Investment Strategy of an LGPS Fund must include *"the authority's approach to pooling investments, including the use of collective investment vehicles and shared services."* In reality the present position with Investment Pooling is therefore that while LGPS Funds need to demonstrate commitment to the principle, the actual pooling of particular assets is in essence ultimately voluntary.

The latest available indication, with any real provenance, as to when there may be progress in relation to a Consultation relating to any of the issues discussed above is contained in the SAB statement of 2 February 2022. This refers to "…*an expected summer consultation…"* covering Pooling, TCFD (climate risk and reporting regulations) and the LGPS issues in the Levelling Up White Paper.

An LGPS Consultation incorporating TCFD, Pooling and the White Paper proposals will be a major undertaking particularly given the potential legal issues around any attempt to make Pooling genuinely mandatory. Therefore, for the DLUHC to issue such a Consultation by summer 2022 would be an achievement in itself. Even if a Consultation were issued in the summer a period of at least 6 months for the implementation of any proposals could reasonably be anticipated. Therefore, 1 April 2023 or thereabouts would appear the likely earliest that any new Regulations and/or Guidance relating to Investment Pooling and TCFD reporting by LGPS Funds might become effective.

As stated in the September 2021 LGPS Update the Government confirmed, in May 2021, that the LGPS Regulations will be amended to remedy the existing Age Discrimination in the LGPS once primary legislation had been passed by Parliament. The Public Service Pensions and Judicial Offices Bill has now completed most of the stages in the Parliamentary process. The Bill has now passed the First Reading, Second Reading, Committee, Report, and Third Reading Stages in both the House of Lords and House of Commons. The Bill completed the Report and Third Reading Stage in the House of Commons on 22 February 2022 and given it originated in the House of Lords will now return there for consideration of amendments made by the Commons.

4. Cost Control Mechanism

On 4 October 2021, the Treasury announced its intention to amend the Cost Control mechanism of the major public service pension schemes, including the LGPS. This followed the publication of a report by the Government Actuary on 15 June 2021 and a consequent Treasury Consultation of 24 June to 19 August 2021. The Public Service Pensions Act 2013 introduced into the seven public service pension schemes, including the LGPS, a Cost Control mechanism to seek to ensure the cost of providing pensions is kept within a range of costs. This seeks to ensure a "fair" balance with regard to the cost of providing defined benefit public service pensions between scheme members and the taxpayer.

The objectives of the Cost Control mechanism were – to protect taxpayers from unforeseen risks, to maintain the value of pension schemes to the members, to provide stability to benefit levels in that the operation of the mechanism should only be triggered by *"extraordinary, unpredictable events."* The Cost control mechanism is primarily concerned with calculating the cost of providing benefits to employees of each of the major public service pension schemes.

The cost control mechanism is a form of risk sharing arrangement that assesses certain elements of the costs of the schemes. If the assessed cost has decreased/increased by more than 2% of pensionable pay compared to their original level, then member benefits/contributions are increased/reduced to bring the assessed costs back to the original level.

For the LGPS in England and Wales there are two cost control mechanisms: The employer cost cap (ECC) operated by HM Treasury, and the future service cost (FSC) as operated by the LGPS Scheme Advisory Board (SAB). Either process can result in changes to the Scheme design and/or employee contribution rates if the costs of the LGPS move sufficiently from a "target cost." In view of Government concerns that the ECC Cost Control mechanism was not operating in line with its original objectives and in particular, the intention that it would only be triggered by *"extraordinary, unpredictable events,"* the Chief Secretary to the Treasury requested the Government Actuary to conduct a review of this Cost Control mechanism.

On 15 June 2021, the final report of the Government Actuary's review of the cost control mechanism across the seven major public service pension schemes, including the LGPS, operated by HM Treasury, was published ("Cost control mechanism Government Actuary's review," Final report, 27 May 2021). Paragraph 1.17, on page 11, of the report confirmed that the review did not consider the separate cost control mechanism for the LGPS which is operated by the Scheme Advisory Board.

Following the publication of the Government Actuary's review the Treasury launched a Consultation on 24 June 2021 (which closed on 19 August 2021) entitled "Cost control mechanism consultation: Proposal to reform the mechanism." This Treasury Consultation included the statement (paragraph 5.1, page 16) *"The Government has carefully considered the analysis and recommendations contained in the GA's final report. Having reflected on this, the Government proposes making three changes to the cost control mechanism, all of which are in line with the GA's recommendations:"*

The three proposals may be summarised as:

- that the cost control mechanism only considers past and future service in the reformed (present) schemes and exclude consideration of legacy schemes

- widening the cost corridor from 2% to 3% to *"improve the stability of the mechanism"*

- *"introducing an 'economic check'"* where there is a breach of the cost control mechanism to ensure broader long term economic conditions are considered before any breach is implemented

The LGPS Scheme Advisory Board for England and Wales (SAB) responded to this Consultation on 19 August 2021. This response expressed, in the specific context of the LGPS, concerns regarding all three proposals. Seven individual LGPS Funds also responded to the Consultation.

On 4 October 2021, the Treasury issued its response to the Consultation of 24 June to 19 August entitled "Public service pensions: Cost control mechanism consultation response." This confirmed the Government's intention to amend the Cost Control mechanism to consider only reformed schemes, introduce a 3% cost corridor, and introduce an "economic check." The News section of the SAB website states (4 October 2021) *"Although not directly addressing the concerns of the LGPS the response does acknowledge them and commits to discussing with stakeholders appropriate ways to introduce these changes, how the E&W SAB cost management process can be adapted and how the principle of that process could be extended to the Scotland and NI schemes."*

5. Review of 2019 Actuarial Valuations – Section 13 Report by the Government Actuary's Department

On 16 December 2021, the DLUHC published the Government Actuary's Department (GAD) report on the 2019 LGPS Actuarial Valuations. The main report is sixty pages long. There is also an Appendices paper of sixty-two pages and a twenty two page Funding Analysis paper.

The GAD was appointed by the (then) MHCLG to report under Section 13 of the Public Service Pensions Act 2013 in respect of the 2019 Actuarial Valuations of the Funds in the Local Government Pension Scheme in England and Wales (LGPS). The 'Overall Comments' made by GAD on page 4 of the main report state, *"In aggregate the funding position of the LGPS has improved since 31 March 2016; and the scheme appears to be in a strong financial position…"* and specifically that since the 2016 Valuation across the LGPS in England and Wales as a whole *"The aggregate funding level on prudent local bases has improved from 85% to 98% (at 2019)"*

Section 13 requires GAD to report on whether the following aims were achieved:

- **Compliance:** whether a Fund's Valuation is in accordance with the Scheme Regulations

- **Consistency:** whether the Fund's Valuation has been carried out in a way which is not inconsistent with other Fund Valuations within the LGPS

- **Solvency:** whether the rate of Employer Contributions is set at an appropriate level to ensure the solvency of the Fund

- **Long term cost efficiency:** whether the rate of Employer Contributions is set at an appropriate level to ensure the long-term cost efficiency of the Scheme, as measured on an individual Fund basis

The first two issues are concerned primarily with the methods of the four Actuarial firms (Aon, Barnett Waddingham, Hymans Robertson, and Mercer) who undertake Actuarial Valuations for LGPS Funds.

The issues of Solvency and Long Term Cost Efficiency are Fund specific. In respect of **Solvency** and **Long term cost efficiency** GAD looked at a range of metrics (10 in all, with 5 each for Solvency and Long term cost efficiency) and then assigned a *"colour coded flag"* to each LGPS Fund in England and Wales for each metric. These range from Red to Amber to White to Green and are explained on page 12 of the main report. A Red flat indicated *"a material issue that may result in the aims of section 13 not being met."* It is extremely pleasing to note that there were no red flags assigned to any LGPS Fund in England and Wales. An Amber flag indicates *"a potential material issue…In isolation this would not usually contribute to a recommendation for remedial action in order to ensure solvency or long term cost efficiency."* Only four Funds across England

and Wales (one English County and three in London) were Amber flagged. A White flag *"is an advisory flag that highlights a general issue but one which does not require an action in isolation."* A Green flag indicates *"that there are no material issues…"* The total lack of red flags and the fact that out of over 80 Funds examined only four received one Amber flag clearly indicates the overall robustness, based on the GAD analysis, of the approach to funding issues of the LGPS across England and Wales. Based on GAD analysis all LGPS Funds in England and Wales met the aims of **Solvency** and **Long term cost efficiency.**

The report on the 2019 Actuarial Valuations has been generally well received by the Actuarial firms who support the LGPS. This is in clear contrast to their response to the report on the 2016 Actuarial Valuations which resulted in a joint letter which raised *"some material concerns"* regarding the detail of that report.

Briefly, the main findings of the GAD report on the 2019 Valuations were:

- **Compliance -** Fund valuations were compliant with relevant regulations.

- **Consistency –** Funds/Actuaries had adopted a consistent dashboard to aid stakeholders when comparing results for different Funds as recommended in GAD's report on the 2016 Valuations. However, differences in methodology and assumptions do not allow like for like comparisons. GAD were also concerned about what they consider to be *"particular inconsistencies in the way Academy conversions are carried out in different funds, which derive from different valuation approaches"* (Page 5 of the main report).

- **Solvency –** The size of Pension Funds has grown considerably more than local authority budgets over the three years to 31 March 2019. This therefore, in GAD's view, presents greater risk going forward, despite the general improvement in Funding levels. Page 7 of the main report includes the statement *"Given that pension funding levels change it is not unlikely that a period of increased pension contributions may be required at some point in the future. If additional spending is required for pension contributions this may lead to a strain on local authority budgets…"*

- **Long term cost efficiency –** At page 51 of the main report GAD state *"Long term cost efficiency (LTCE) relates to not deferring payments too far into the future so that they affect future generations of taxpayers disproportionately."* GAD is clear in its report regarding its view of the need to consider the balance of cost between current and future taxpayers. GAD highlighted four individual Funds (three in London and the Royal County of Berkshire Fund) as raising potential concern in relation to long term cost efficiency; this is two less than in 2016. GAD also raises (pages 59 and 60 of the main report) the issue of the use by some Funds of Asset Transfers and Contingent Property Transfers from the Council (Administering Authority) to the Pension Fund. Whilst *"not commenting on the actions of any fund that holds such an asset"* the report raises a number of *"potential concerns"* regarding such arrangements and recommends *"the Scheme Advisory Board review asset transfer arrangements from local authorities to ensure that appropriate governance is in place around any such transfers to ensure long term cost efficiency"*

The Appendices document includes detailed results and GAD analysis covering all LGPS Funds in England and Wales.

The main report included four Recommendations which seek to promote:

1. Improved consistency in the approach to assessing emerging and existing key issues including Academy conversions and "McCloud" (Page 5).

2. Ensuring deficit recovery plans can be demonstrated to be a continuation of the previous plan (Page 8).

3. Continuing improvements in transparency through an expanded Valuation dashboard with additional information, provided by the Fund Actuaries (Page 8).

4. Appropriate governance arrangements around asset transfer arrangements from local authorities to Pension Funds *"to achieve long term cost efficiency."* (Page 60).

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The GAD Section 13 Report for 2019 may be accessed at
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1040197/S13_final_report.pdf

The Appendices to the GAD Section 13 Report may be accessed at
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1040200/S13_Appendices.pdf

The Funding Analysis document to The GAD Section 13 Report for 2019 may be accessed at
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1040198/FAPaper2019_Final.pdf