Sackers

Public sector briefing

May 2016

Highlighting the latest developments in public sector pensions

Welcome

As the sun (hopefully) returns to the British Isles, the UK has some big questions to face: will the new Top Gear be any good; is it really appropriate to call a serious polar research vessel "Boaty McBoatface" and, of course, where should I go for my summer holiday?

In the world of the LGPS, however, we have reached crunch time for asset pooling. As the participants of each of the "British Wealth Funds" crystallise, the focus shifts to implementation and how best to make good on the Government's ambitious timeframe and cost saving aspirations. In our spotlight on the great LGPS investment exodus, we look at some high level legal questions on the pooling project.

Of course, through all this the key business of running the LGPS must go on. In our Three Key Issues below we cover:

- Protection of GMP for public sector workers
- TPR's statement on public service scheme standards
- Budget 2016.

Michaela Berry and Ralph McClelland are attending the PLSA Local Authority Conference in May, and Ralph will be speaking on the new Investment Regulations in the afternoon of Tuesday 17 May. Please do come and say hello!

Three key issues

Protecting the GMP of public sector workers

In addition to the statutory increases that schemes are required to pay, the second tier of the State pension (known as the State Second Pension, formerly SERPS) effectively provides cost-of-living increases on GMPs for members of both private and public sector schemes.

Such increases will not be paid to those who reach SPA on and from 6 April 2016 and qualify for the new single-tier State Pension, as there is no mechanism by which to do so. As a result, on 1 March 2016 HM Treasury ("HMT") announced that the Government will continue to "price protect" the GMP of certain public sector workers.

With the aim of ensuring that public service pension payments continue to be equal between men and women, those who reach SPA between 6 April 2016 and 6 December 2018 (when SPA equalises) will receive a fully indexed public service pension for life. This new obligation will affect all public service schemes, including the LGPS.

Three key issues cont.

In early April, HMT released an updated note on the operation of pensions increase legislation for public service pension schemes which incorporated the new policy announcement. The accompanying Direction came into force on 6 April 2016, and revokes the previous direction made in July 2000.

A consultation on how to address the issue in the longer-term, "recognising the increased value of the new State Pension, and seeking to balance simplicity, fairness and cost for members, public service pension schemes and the taxpayer" is expected later in 2016.

TPR calls on public service schemes to raise standards

Public sector schemes have been answerable to the Pensions Regulator ("TPR") since April 2015 in terms of both governance and administration.

In December 2015, TPR issued a press release warning public service pension schemes to improve their standards of governance, as figures suggested that, despite progress being made, a large proportion were not ensuring that they complied with requirements introduced by the Public Service Pensions Act 2013 and the standards set out in TPR's Code of Practice.

The figures came from a survey which had assessed what schemes were doing to meet these requirements. The survey found that, for example, while nine in ten respondent schemes had made progress in establishing a pension board, less than a third had a plan of action in place to ensure they were meeting their new legal duties and less than half had reviewed their schemes against TPR's Code.

Andrew Warwick-Thompson, Executive Director at TPR, suggested at the time that the research revealed "a concerning picture of some public service schemes failing to engage fully with the requirements on governance and administration". However, TPR did also note that there had been "some encouraging progress".

Six months down the line from the period of the survey, we would expect schemes to have had time to make some of the "significant progress" TPR was hoping for, alongside managing their funding and investment issues. And while TPR expects compliance with its codes, its initial focus is on educating and enabling schemes to achieve the required standards rather than enforcement.

Sackers has lots of experience in advising schemes on compliance with TPR's codes and guidance, and administering authorities should get in touch with one of our Public Sector team if they would like to discuss the issue further.

Budget 2016

The Budget of 16 March 2016 brought news for public sector schemes.

The Government announced that it had reviewed the discount rate used to set employer contributions to unfunded public service schemes, with the intention of ensuring that these contributions fairly reflect the cost of providing public sector pensions. The new discount rate was fixed at 2.8% above CPI, down from 3% (set at the last review, in 2011). Payments to beneficiaries remain unchanged by the measure.

Although this maintains the 2011 pledge by the Coalition government to protect public sector schemes from negative benefit changes for 25 years, it will certainly create extra costs for employers. A reduced discount rate will increase the cost of future benefits, and will result in higher employer contributions to the schemes from 2019/20. The expected increase is in the region of £2bn per annum. In his Budget speech, the Chancellor said that the change should "be affordable within spending plans that are benefiting from the fiscal windfall of lower inflation".

The change also affects the LGPS, as the discount rate is used by public service pension schemes for purposes such as the calculation of cash equivalent transfer values ("CETVs"). A note issued by HMT in the wake of the Budget confirmed that both unfunded schemes and the LGPS should adopt the revised rate for CETVs where necessary with immediate effect.

In addition, the Government announced at the Budget that it would support proposals by local administering authorities to establish both a small number of British Wealth Funds by 2018 by combining LGPS assets into much larger investment pools, and a new national infrastructure investment platform for LGPS funds.

Spotlight – LGPS Pooling: the great LGPS investment exodus

Following the Government's consultation on asset pooling, administering authorities are preparing for a substantial transition project involving the relocation of each section's assets into the emerging "British Wealth Funds". This is a key stage in the development of the new pooled funds and each authority should understand its own role and responsibilities.

Where we are

The Department for Communities and Local Government ("DCLG") is still considering the consultation responses.

- "Refined and completed" submissions must be provided to DCLG by authorities by 15 July 2016.
- In terms of implementation, the Government believes that new vehicles could be established by the second half of 2017 and expects the transfer of assets to begin in April 2018 (though illiquid assets may take longer). This is an ambitious timescale.
- Project POOL's joint working group (representing 24 sections) published its findings and analysis in January. Notably, the report moots the idea of LGPS wide asset pools for some asset classes.

What are the legal questions?

Administering authorities do not have a choice as to whether they pool, but they are responsible for the terms on which they do so. The aggressive timescale for implementation should not prevent careful scrutiny of the pooling proposal from commercial, governance and legal perspectives.

Each individual administering authority will need to carefully consider the detail associated with its pooling arrangements:

- What is the division of rights, responsibilities and risks?
- What residual discretions will be retained to the administering authority and how will that be documented?
- What recourse will the administering authority have as regards the providers of the fund?

Structure and obligations – identifying conflicts

Any pooling arrangement will involve separating the pool from its participating administering authority. The pool (however it is constituted) needs to have some degree of autonomy and delegated authority. This means that the interests and obligations of the pool, at some point, are likely to become separated from that of its participants. As soon as this separation occurs, there is a potential for conflicts of interest between the interests of the pool and those of its participants.

Administering authorities will need to consider whether their own obligations are aligned with those of the pool. Our expectation is that there will be points on which this is not the case. Regardless of how closely the authorities have become accustomed to working with the pool provider, such conflicts must be identified and proactively managed. This means the authority will need to consider its own interests and may, therefore, need its own advice.

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Contact

Sackers is the leading law firm for pension scheme trustees and employers. Over 50 lawyers focus on pensions and its related areas, including our public sector experts who provide practical and specialist help on legal, regulatory and governance issues within the public sector.

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Quarterly legal update	28/07/2016	Breakfast seminar (09.00am – 10.30am) The latest legal and regulatory developments in the pensions world.
Quarterly legal update	10/11/2016	Breakfast seminar (09.00am – 10.30am) The latest legal and regulatory developments in the pensions world.

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