**JOHN RAISIN FINANCIAL SERVICES LIMITED**

# Haringey Pension Fund

# LGPS Update

# A paper by the Independent Advisor

# June 2022

## Introduction

This paper provides an update on five issues relating to the LGPS. In respect of the first three some, or possibly all, of these are expected to be the subject of a Consultation to be issued by DLUHC in the Autumn of 2022. There is presently no indication of a timescale for a Consultation on the fourth issue. The fifth issue may to be subject to a further announcement possibly (but not necessarily) before Parliament rises for its Summer recess in July 2022. These issues are:

1. Asset (Investment) Pooling

2. Climate – Task Force on Climate Related Financial Disclosures (TCFD) Reporting

3. Levelling Up White Paper and the LGPS in England and Wales

4. Good Governance in the LGPS

5. Age Discrimination in the LGPS (commonly referred to as "McCloud")

## 1. Asset (Investment) Pooling

The Consultation on further developing Asset (Investment) Pooling expected since 2019 has not yet been issued. The latest indication from the DLUHC and Scheme Advisory Board statements/sources is that this is intended to be included in a wider LGPS Consultation to be issued in Autumn 2022.

In November 2015, the government issued guidance entitled ***"Local Government Pension Scheme Investment Reform Criteria and Guidance."*** This set out criteria for the (then) 89 LGPS Funds in England and Wales to form Asset Pools whose fundamental role is to select asset managers to implement the Investment Strategy determined by each individual LGPS Fund. This resulted in the creation of 8 Asset Pools across the LGPS. These had a wide range of both regulatory and governance structures and have, individually, developed very differently since 2015. All London Borough LGPS Funds (and the City of London) became members of the London Collective Investment Vehicle (London CIV).

Crucially, however, all Asset Pools are creations of their constituent LGPS Funds, owned by them, and ultimately accountable to them. Furthermore, all assets continue to belong to the individual LGPS Funds not the Pools.

The sole fundamental role of Asset Pools, including the London CIV, is to select and monitor investment managers to implement the Investment Strategy of their constituent (individual) LGPS Fund's. The setting of Investment Strategy (including the types of Assets and their proportions) which academic studies clearly demonstrate is the primary driver of investment returns remains the responsibility of each individual LGPS Fund. To fulfil its role, it is crucial that an Asset Pool provides/procures investment products that meet the needs of its constituent LGPS Funds.

The (then) MHCLG issued a Consultation on a new framework for Pooling 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 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 extent to which individual LGPS Funds across both England and Wales, and within London itself, have pooled their assets varies enormously. Some Funds have now placed most of their assets with their Pool while some have placed little.

There can be no doubt, however, based on both written statements and speeches made by Civil Servants that Pooling is here to stay and that the DLUHC intend to develop it further. The question is how? The DLUHC will certainly need to think carefully given responses to the Consultation of 2019 and the 2020 Supreme Court case relating to another LGPS issue which resulted in a judgement which included reference to the extent to which the Secretary of State (DLUHC) can use Statutory Guidance (rather than Regulations) to mandate how LGPS Funds should act.

There have been various suggestions as to the nature of the Consultation that the DLUHC will issue. Particular important themes will be the extend of mandation which could cover a range of issues including the structures and governance of Asset Pools, and possible timescales. One suggestion is that the Consultation might include "comply or explain" provisions. Whatever the contents of the Consultation, however, given the broad range of views amongst the (approximately) 85 LGPS Funds together with the diverse approach to Pooling that has developed since 2015 there will doubtlessly be a vigorous response from the LGPS community when the Consultation is (finally) issued.

## 2. Climate Reporting – Task force on Climate Related Financial Disclosures (TCFD) Reporting

In 2015 the Financial Stability Board (established in 2009 by the G20 countries) created the Task Force on Climate Related Financial Disclosures (TCFD) to develop consistent climate related financial risk disclosures for use by companies, banks, and investors in providing information to stakeholders.

In 2017 the TCFD published its final recommendations. The Task Force recommendations were structured around four thematic areas that represent core elements of how organisations operate - Governance, Strategy, Risk Management, Metrics and Targets. The 2017 report summarised these as follows

1. **Governance:** *“Disclose the organization’s governance around climate-related risks and opportunities.”*

2. **Strategy:** *“Disclose the actual and potential impacts of climate-related risks and opportunities on the organization’s businesses, strategy, and financial planning where such information is material.”*

3. **Risk Management:** *“Disclose how the organization identifies, assesses, and manages climate-related risks.”*

4. **Metrics and Targets:** *“Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.”*

In the United Kingdom, the Department for Work and Pensions (DWP) has consulted upon and issued final Regulations (***The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021***) on TCFD reporting by private sector pension schemes. These set out how private sector schemes are required to report against the TCFD framework.

The DWP Regulations do not apply to the LGPS as the DWP has no role in relation to the Regulations relating to the governance and investment of the LGPS. This responsibility lies with the DLUHC (formerly the MHCLG).

A Consultation to amend the LGPS Regulations to apply TCFD reporting to Local Government Pension Funds was expected by early 2021. This has not yet been issued but is now anticipated to be issued as part of a wider LGPS Consultation expected in Autumn 2022. Such is the delay in issuing a Consultation on applying TCFD reporting to the LGPS (particularly given that DWP issued their Consultation in January 2021 and Regulations came into force from 1 October 2021) the DLUHC should surely now urgently issue its Consultation on this matter. Indeed, this has led some commentators to suggest that consulting in respect of TCFD Regulations for the LGPS is now more urgent than consulting in respect of new Pooling Guidance and that this should be/is the DLUHC’s most urgent issue relating to the LGPS.

When the Consultation is issued, it will seek to apply the TCFD principles in the specific context of the LGPS although it is expected the requirements on LGPS Funds will be very similar to those which apply to the private sector. There will however, it is believed, be some differences. For example, it is expected the Regulations will apply at the same time to all LGPS Funds whatever their size (in the private sector the Regulations apply/applied to Funds with assets of over £5bn earlier than other Funds) and unlike for private sector Funds there are not expected to be financial penalties for non compliance by an LGPS Fund.

It is important that the Haringey Fund carefully considers, and responds as it considers appropriate, to this Consultation when issued as the MHCLG (now DLUHC) have stated (to the Scheme Advisory Board Investment Governance and Engagement Committee) that the regulatory requirement to report on TCFD in the context of the LGPS Regulations will lie with individual LGPS Funds rather than their Asset Pool.

## 3.Levelling Up White Paper and the LGPS in England and Wales

On 2 February 2022, the DLUHC issued a White Paper ***"Levelling Up the United Kingdom"*** which sets out the Government's ambition and plans in terms of "levelling up." The White Paper is very detailed and lengthy (the main document is 332 pages cover to cover and the Technical Annexe 54 pages).

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 representatives of the LGPS Scheme Advisory Board for England and Wales (SAB) met with DLUHC officials. This was to clarify the White Paper's aims in relation to the LGPS.

Later on 2 February 2022 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."*

A paper to the SAB Board meeting held on 7 March 2022 also states (based on the 2 February meeting between DLUHC and SAB representatives) that *"The White Paper makes references to 'increasing investment'. It would appear that government is not looking for LGPS funds to count existing investments in this area. The plan should rather set out how new investments will seek to achieve the ambition in this area."* and *"In the matter of fiduciary duty there does not appear to be any expectation that LGPS funds should put intervention outcomes above those of return. Instead, the intention would seem to be for funds to actively seek opportunities in this space which contribute to the levelling up agenda while at the same time providing expected levels of return."*

Therefore, in essence the White Paper, supplemented by the clarifications provided by DLUHC officials on 2 February 2022, contains an exhortation to the LGPS to invest in UK infrastructure including housing. The wording of the White Paper 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 White Paper is merely stating that LGPS Funds be asked to publish plans to increase investment in infrastructure and housing across the UK. This is, in essence, likely to be the approach of the Consultation. LGPS Strategic Asset Allocations are not driven by government exhortations but by funding/investment requirements influenced by factors such as funding levels; actuarial assumptions; risk/diversification; inflation; cashflow; existing allocations; appropriate consideration of Environmental, Social and Governance (ESG) issues.

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 primarily for strategic investment reasons (incorporating consideration of ESG issues) rather than because of Government exhortation even in the context of a Consultation and subsequent Regulation possibly supplemented by Statutory Guidance.

Indeed the approach suggested in the previous two paragraphs is clearly supported in the following quote from a letter dated 27 April 2022 from the Chair of SAB (Councillor Roger Philips) to the Minister of State responsible for the LGPS (Kemi Badenoch MP) which includes the statement *"…the Board is fully supportive of the aim of increasing investment in the type of "local" and "impact" projects envisaged in the White Paper and believes that the LGPS sector is willing to support the levelling up agenda wherever possible <u>and appropriate within their funding and investment strategy policies</u>…"* (my underlining).

## 4.Good Governance in the LGPS

The Good Governance in the LGPS project was initiated by the SAB in 2018. The project sought to fundamentally enhance and strengthen the governance of the individual LGPS Funds in England and Wales. The project took place over three phases and resulted in three reports which progressively developed a broad range of proposals. Two broad ranging stakeholder working groups (the Standards & Outcomes Group and the Compliance & Improvement group) were established at Phase II to work with Hymans Robertson who were tasked with co-ordinating the Good Governance in the LGPS project. The Independent Advisor to the Haringey Fund was a member of both working groups and the Phase III Implementation Group. The detailed proposals of the Good Governance in the LGPS project in the Phase II report which were further developed in the Phase III report may be summarised as follows:

- The MHCLG (now the DLUHC) to produce Statutory Guidance to establish new governance requirements for Funds to effectively implement the proposals from the Good Governance in the LGPS project

- Each Administering Authority (LGPS Fund) must have a single named officer responsible for the delivery of all LGPS related activity for the Fund – "the LGPS Senior Officer"

- Each Administering Authority must publish an annual Governance Compliance Statement that sets out how they comply with the governance requirements for LGPS Funds as set out in the new Statutory Guidance

- Enhancements to the requirements in relation to - Conflicts of Interest, Knowledge and Understanding, Service Delivery including Business Planning/Budgeting and performance against a key set of indicators

- Each Administering Authority to be required undergo a biennial Independent Governance Review and, if applicable, produce the required improvement plan to address any issues identified.

In February 2021, the SAB received the final Phase III report, considered and approved an Action Plan based on the final report. It was agreed that the Board's Chair (Councillor Roger Phillips) would write to the (then) Local Government Minister Luke Hall MP inviting him to consider the Board's Action Plan.

The Action Plan consists of formal requests from the SAB to the Government to implement the proposals of the Good Governance in the LGPS project. Given DLUHC were represented on both the Phase II Working Groups and the Phase III Implementation Group it is highly likely that the Action Plan will be positively received by the DLUHC. The Action Plan includes the Recommendations in the Phase III report, the consequent proposed actions for DLUHC either by Regulation or Statutory Guidance, and work to be undertaken by SAB.

The approval of the Phase III report by SAB and the submission of the Action Plan to the Government (DLUHC) bring much closer the practical implementation of the Good Governance in the LGPS project proposals. However, implementation of proposals by the DLUHC (likely to be closely but not exactly derived from those of SAB) requires a formal Consultation. Based on statements from SAB, based on discussions with DLUHC it would seem likely that the Good Governance in the LGPS proposals, thought submitted to Government in early 2021, will not form part of the (expected) Autumn 2022 Consultation but will be held over until later.

Notwithstanding this Consultation delay some Funds, including the Haringey Fund are seeking to determine how they can implement (some of) the proposals of the Phase III report prior to the issuing of Regulations/Statutory Guidance from DLUHC and further SAB guidance. Consequently, in this regard, the Haringey Fund commissioned the Independent Advisor to prepare a paper which was considered by the Pensions Committee and Board at its meeting held on 2 December 2021. This paper which may be accessed at www.minutes.haringey.gov.uk/documents/s128178/Appendix1%20-%20Haringey%20Good%20Governance%20Potential%20Implications.pdf provides the background to the Good Governance in the LGPS project and includes links to the Phase III report and the SAB Action Plan. Specifically, the Table in the paper reproduces the Proposals in the Phase III SAB report, contains a commentary on each proposal and its implications, and the Independent Advisor's suggested potential action(s) for Haringey. Those Members of the Pensions Committee and Board who are not familiar with the Good Governance in the LGPS project may wish to access the paper to learn more about this hugely important initiative.

At its meeting on 2 December 2021 the Pensions Committee and Board took a positive approach to implementing the Good Governance in the LGPS proposals Resolving *"To request that officers look into each recommendation in the Independent Advisor's Good Governance in the Local Government Pension Scheme (LGPS) Project paper, appended as Appendix 1, and provide an update on the options and likely implementation dates. The Pensions Committee and Board noted that this report was likely to be considered a number of times and that it may be useful to present the recommendations in sections, possibly focusing on short term and then long term options."*

## **5. Age Discrimination in the LGPS (commonly referred to as "McCloud")**

The Public Service Pensions Act 2013 which reformed all the major public service pension schemes from 2014 or 2015 included provision for protections for older members designed to ensure they would not be worse off as a result of the introduction of the new schemes. In 2018 the Court of Appeal ruled that in the case of the Judges' and Firefighters Pension Schemes this was (age) discriminatory against younger members. In July 2019, the Government confirmed that there would be changes to all public service pension schemes, including the LGPS, to remove this age discrimination. This whole issue is now commonly referred to as "McCloud."

On 16 July 2020, the then MHCLG issued a Consultation called ***"Amendments to the statutory underpin"*** to address the age discrimination identified in the LGPS. However, given the age discrimination in the LGPS and other public service pension schemes had resulted from the Public Service Pensions Act 2013 there was a need for revision to primary legislation before the LGPS Regulations could be amended. On 11 May 2021, the Government confirmed that a Public Service Pensions and Judicial Offices Bill would introduce amendments to incorporate the McCloud judgment into public service pension schemes. On 13 May 2021, in a Ministerial Statement, Luke Hall MP, the then Minister of State with responsibility for the LGPS, confirmed that it was intended that these remedial Regulations would come into force on 1 April 2023 but *"will be retrospective to 1st April 2014."* Referring to the Consultation of July 2020 it was confirmed that key elements of this would form changes to the LGPS Regulations which would be made after the Public Service Pensions and Judicial Offices Bill had become an Act.

The Public Service Pensions and Judicial Offices Act came into effect from 10 March 2022. There have been suggestions that the DLUHC may possibly issue an announcement relating to the actual amended LGPS Regulations before the Parliamentary recess commences in July 2022. However, there is already clarity regarding the overall nature of the remedy from the Ministerial Statement of 13 May 2021 and a letter issued from the Head of Local Government Pensions at the DLUHC on 22 March 2022 which suggested that for purposes of the 2022 Actuarial Valuations Funds apply the following:

- *It should be assumed that the current underpin (which only applies to those members within 10 years of their NPA at 31 March 2012) will be revised and apply to all members who were active in the scheme on or before 31 March 2012 and who join the post 1 April 2014 scheme without a disqualifying service gap.*

- *The period of protection will apply from 1 April 2014 to 31 March 2022 but will cease when a member leaves active service or reaches their final salary scheme normal retirement age (whichever is sooner).*

- *Where a member remains in active service beyond 31 March 2022 the comparison of their benefits will be based on their final salary when they leave the LGPS or when they reach their final salary scheme normal retirement age (again whichever is sooner).*

- *Underpin protection will apply to qualifying members who leave active membership of the LGPS with an immediate or deferred entitlement to a pension.*

- *The underpin will consider when members take their benefit so they can be assured they are getting the higher benefit.*

In conclusion, there is now further clarity as to the remedy for “McCloud” in the context of the LGPS particularly in the light of the enactment of the Public Service Pensions and Judicial Offices Act 2022, and the letter from the DLUHC issued on 22 March 2022. However, the detail in respect of further Consultations and the actual Regulations are still awaited. There are still complexities around matters of detail including, for example, taxation. Even if an initial Consultation occurred in July 2022, it has been suggested that at least two Consultations may be needed to resolve all the regulatory detail to remedy “McCloud.” Additionally for Haringey and every other individual LGPS Fund there is a huge amount of work to be undertaken to apply the finalised remedy (when known) to the benefit entitlement of individual members of the LGPS.

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