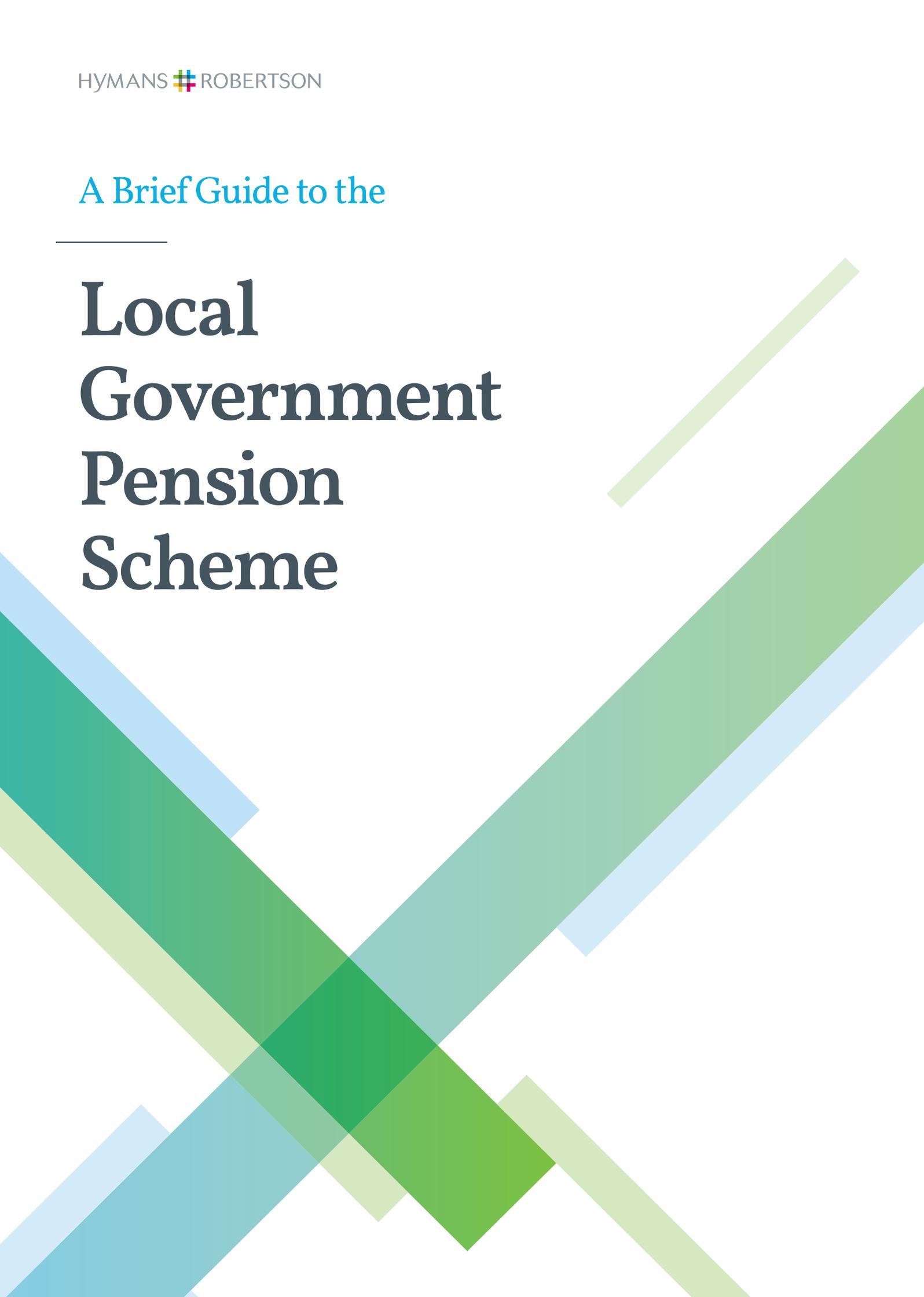


A Brief Guide to the

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# Local Government Pension Scheme



# Introduction from Catherine McFadyen

The Local Government Pension Scheme (LGPS) plays a crucial role in our local communities, delivering high quality pensions and ensuring good living standards in retirement for local government workers and their dependants. The LGPS is funded and administered locally and Hymans Robertson is proud to have been advising and supporting local authorities in running the Scheme for 100 years.

As with other areas of local government, the LGPS has been subject to a period of rapid change. Since 2014, the Scheme has seen the introduction of a new style of benefits, a rapid expansion of the number of employers, the introduction of investment pools for funds in England and Wales (E&W), as well as being impacted by legal rulings and changes in Government policy. Local funds have been resilient in adapting to that change and have taken on new responsibilities despite the backdrop of COVID-19, leading to financial pressure and squeezed resource.

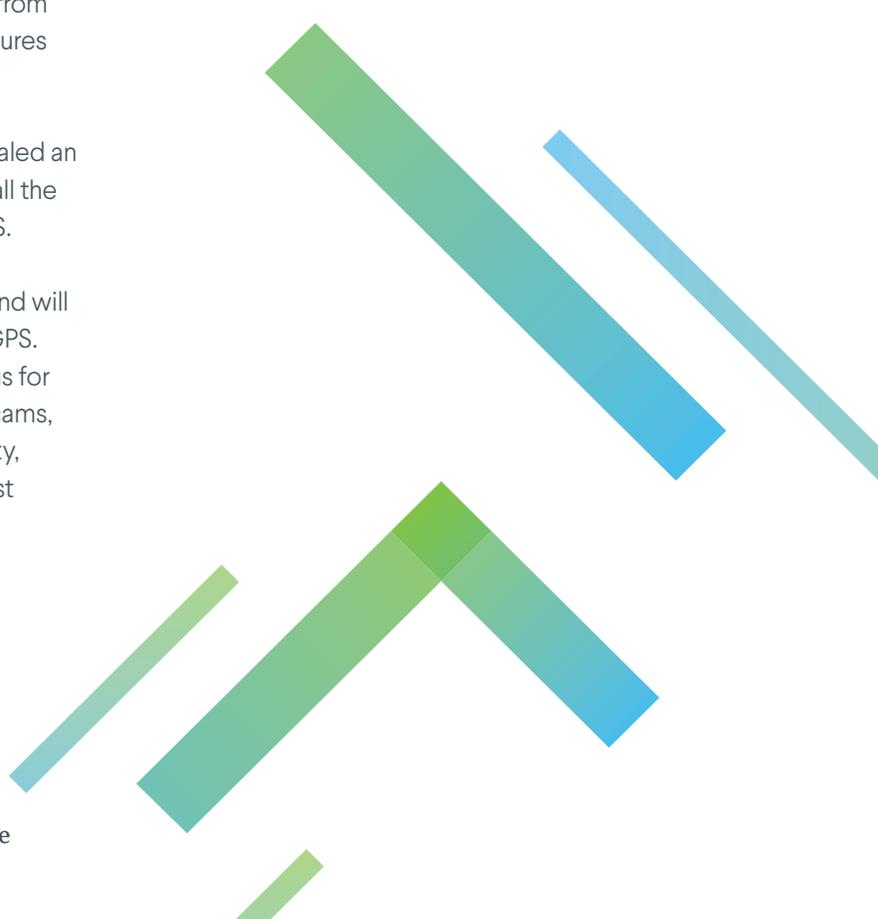
The eight LGPS investment pools are now well established. Most assets have now transitioned from local Funds into the Pools and governance structures are now in place.

In March 2021, The Pensions Regulator (TPR) signaled an intention to create a single code of practice for all the pension schemes it regulates, including the LGPS. The new code is subject to consultation but is expected to begin implementation in late 2021 and will replace the code that currently applies to the LGPS. The single code will introduce new areas of focus for the LGPS, including protecting members from scams, which, when considered alongside cyber security, shows TPR will expect all schemes to have robust processes in place to protect members.

Local stakeholders are also demanding more. LGPS members have expectations of a modern, streamlined and supportive service, LGPS employers require more fund officer time, while external groups seek to place environmental, social and governance issues at the heart of investment decisions.

We were delighted to assist the England and Wales Local Government Pension Scheme Advisory Board (SAB) carry out an important piece of work known as the Good Governance Project, which sought the views of LGPS practitioners, committee and pension board members and advisers on ways in which the governance structures and practices of the LGPS might be improved to respond to many of these challenges.

At the time of this guide being published, the E&W SAB's Good Governance recommendations have been submitted to government for them to take forward. Over the next year, LGPS funds will be working to put new arrangements in place so they are ready for when the guidance is formally issued.



This guide is aimed at elected members, Scheme member and employer representatives, who sit on pension committees or panels and exercise a decision-making function in respect of LGPS funds, and members of local pension boards whose role is one of assisting and oversight. It will be particularly useful to committee and board members who are new to the role of dealing with an LGPS pension fund. It is also useful for those who are already involved in pension committees or boards and are looking for a summary of the important role that they play in the 'stewardship' of their funds. This guide can help by familiarising you with some key areas and providing background on -

- Understanding of the Local Government Pension Scheme (LGPS) and how it is set up.
- The main areas of risk involved in running your fund and the management of these risks.
- The types of decisions that you may be asked to make or how you might provide assistance to the administering authority.

With 100 years' experience of local government pension funds, Hymans Robertson has a long history of working with local authorities. We currently provide advice to over half of the LGPS funds in the UK. We use this extensive experience to help make life easier for those, like you, who are responsible for the successful running of your funds.

I hope you find this brief guide helpful.

*Catherine McFadyen*

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# Basics of the Local Government Pension Scheme (LGPS)

The LGPS is a **defined benefit, funded** occupational pension scheme, set up under regulations set by Parliament (Scottish Ministers in Scotland and the Northern Ireland Assembly in Northern Ireland). The pension scheme provides pension benefits for those who work in the local authority arena and is open to employees of local government as well as a wide range of other public service employers e.g. charities, private sector contractors. The pension benefits under the LGPS are set nationally and are very secure as they are written in statute.

Separate Regulations for administration, governance and investments apply in England & Wales, Scotland and Northern Ireland, but the scheme is broadly similar in each country or province.

Although the LGPS is a nationwide scheme it is administered locally and is made up of many standalone funds – normally administered by local authorities. It is the management and governance of these standalone funds that we consider in this booklet.

## Key LGPS Facts England and Wales

- Made up of 88 regional funds
- Around 6.1 million members
- Total fund assets are £272.4 billion
- Total expenditure on benefits is over £12.7 billion p.a.

(Source: MHCLG LGPS Funds: England and Wales statistical release 2019/20)

## Key LGPS Facts Scotland

- Made up of 11 regional funds
- Over 0.55 million members
- Total fund assets of more than £48 billion
- Total expenditure on benefits is around £1.4 billion p.a.

(Source: Scottish Scheme Advisory Report 2018/19)

## Definitions

### CARE

From 1 April 2014, the LGPS in England and Wales (2015 for the other regions) became a Career Average Revalued Earnings based scheme with pension accruing each year based on scheme members' earnings over their career. Previously the benefits under the scheme were based on a formula linked to length of service and pensionable pay on leaving.

### Funded

This means that a fund is built up from employee and employer contributions, investment income and growth in order to meet future benefit payments as they fall due as opposed to being an unfunded or pay-as-you-go scheme, like most other public service schemes.

### Admission bodies

Employers that have applied to participate in the scheme under an admission agreement – usually employers such as charities or contractors. Admission bodies usually provide a public service which is closely linked to the functions of a local authority.

# Who's who in the LGPS

## The main parties involved in the management and administration of the LGPS are:

### The administering authority

Usually a council – it has the responsibility of managing all aspects of the fund.

### Ministry of Housing, Communities and Local Government (MHCLG)

The central government department, which has overall responsibility for the strategic management and policy making in relation to the LGPS in England and Wales. The Scottish equivalent is the Scottish Public Pensions Agency, whilst the Northern Irish version is the Department of the Environment.

### Officers

Employees of the administering authority whose role it is to carry out the day-to-day administration and management of the fund on behalf of the elected members. The actual day-to-day administration may be carried out by an in-house team, an external contractor or a local authority shared service.

### The pension committee (or equivalent)

Primarily made up of elected members from the Council. Most Committees have some delegated authority from the administering authority, although some are advisory only. The committee usually has overall responsibility for the fund and provides a similar function to that of trustees in private sector pension schemes.

### The local pension board

Made up of member and employer representatives whose aim is primarily to assist the administering authority in the governance of the scheme. Unlike the pension committee, local pension boards have no direct delegated decision-making responsibilities.

### Advisers

There are many experts whose assistance you may need to rely upon. The list includes auditors, lawyers, investment managers, actuaries, investment, governance and benefit consultants and custodians.

### The Pool (England and Wales only)

There are eight LGPS pools. Each LGPS fund in England and Wales is a member of one of these Pools. Going forward the Fund's pool will be its primary route to implementing its investment strategies.

### Other bodies

Other groups that you will come across include LGA (Local Government Association), who provide guidance on the technical aspects of the LGPS, and CIPFA (Chartered Institute of Public Finance and Accountancy) who provide support on reporting and accountancy aspects.

### The Pensions Regulator

The Regulator is responsible for regulating the governance and administration of pension schemes and has published a code of practice for public service schemes to adhere to.

### Scheme Advisory Board (SAB)

A national body representing employers and scheme members, which works with Government and other stakeholders to encourage best practice, increase transparency and coordinate technical and standards issues. Separate SABs exist for the schemes in England & Wales, Scotland and Northern Ireland.

### Scheme Employers

Local authorities, public service organisations and private contractors providing an outsourced service.

### Scheme Manager

The body responsible for running a public-sector pension scheme. In the LGPS, each administering authority is a scheme manager.

### Scheme Members

Active, deferred or pensioner members within the LGPS.

Your own officers will be able to provide you with details of the people involved in your fund, and your governance arrangements.

# What does the role of the committee entail?

The main decisions that members of a pension committee are likely to have to make are as follows.

## Agreeing the fund's objectives and investment beliefs

- Monitoring progress of the fund's progress towards its objectives
- Using the beliefs to form the fund's investment strategy

## Deciding upon an appropriate investment strategy and structure for your fund

- Considering advice from your investment advisers and the fund's Actuary
- Identifying and managing the fund's key risks
- Setting policy on environmental, social and governance ("ESG") related matters, including climate change

## In relation to the management of your fund's assets

- Liaising with your pool on investment options (England and Wales only)
- Potentially selecting new investment managers (Northern Ireland and Scotland)
- Monitoring performance over time of decisions delegated to other parties (All)

## Pooling LGPS Investments

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Every fund in England and Wales invests a proportion of its assets through one of eight investment pools and the intention is that over time, the majority of assets will be invested in this way.

It is the role of each Administering Authority (usually through the Pension Committee) to set its own objectives, beliefs and strategic asset allocation, as well as setting the fund's policy on Environmental, Social and Governance matters. The responsibility for which investment managers the money is invested with sits largely with the Pool.

The Pension Committee must monitor its own fund's arrangements and ensure the Pool is performing as required.

Your officers will be able to tell you more about the pool in which your fund participates and the current status and timetable of your pooling arrangements.

At the time of writing, there are not formal requirements for pooling in Scotland.

### Dealing with your fund actuary

- Ensuring that you have an appropriate funding strategy for setting contributions
- Agreeing contribution rates at the triennial valuation
- Monitoring the progress of the funding level between valuations

### Ensuring that all relevant documentation is in order

- Reviewing and updating the mandatory documents
- Reviewing administering authority policies as appropriate
- Approving your pension fund accounts in time

### Being responsible for the risk management of the fund

- Maintaining an up-to-date risk register
- Ensuring that appropriate policies are in place to deal with the admission of employers into the fund, and the departure of employers from the fund
- Ensuring the smooth administration of the fund for members and employers
- Keeping an eye out for possible long-term risks e.g. how your longevity experience is changing over time

## Mandatory Documents

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- Pension fund annual report
- Funding Strategy Statement
- Investment Strategy Statement (or Statement of Investment Principles for funds outside England and Wales)
- Governance compliance statement
- Communications Strategy
- Pension Administration Strategy

# Investment Decisions

One of the pension committee’s main tasks include setting the fund’s objectives and investment beliefs, as set out within the requirements of the Investment Regulations.

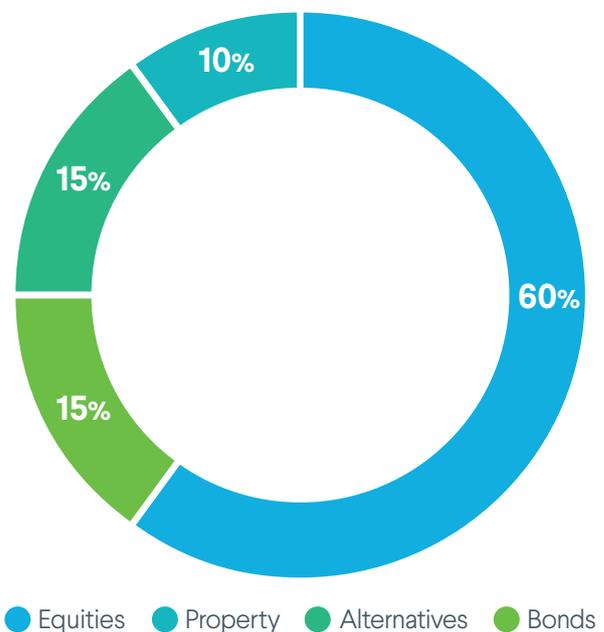
These give a sense of what success looks like for the fund and the framework that you will work within to achieve this success.

- Environmental, social and governance related aspects (including climate change) must be considered when making investment decisions.

Once there is clarity on objectives and beliefs, attention turns to how the fund’s assets should be invested. This is called “setting strategy” (i.e. the mix of asset types). Key things to keep in mind are:

The asset allocation for a typical LGPS fund could look like this:

- Of the asset classes equities, property and alternative assets are essentially “return seeking”. By contrast bonds are usually held for funding stability and security;
- A high allocation to return seeking assets helps to keep pensions affordable. However, return seeking assets increase downside funding risk;
- Diversification (i.e. not putting all of your eggs in one basket) should help to reduce the downside risk;
- A long-term approach, seeking return, is generally considered appropriate – hence the higher allocation to equities and alternatives seen in the LGPS world relative to most private sector pension schemes; and



## Definitions

### Equities

“Shares” in companies give an entitlement to dividends and the prospect of capital gains. Equities are expected to deliver a higher return than bonds over the long term.

### Property

Investments are usually in commercial property. Due to the size of individual properties and the need for diversification, investment is often through pooled funds.

### Bonds

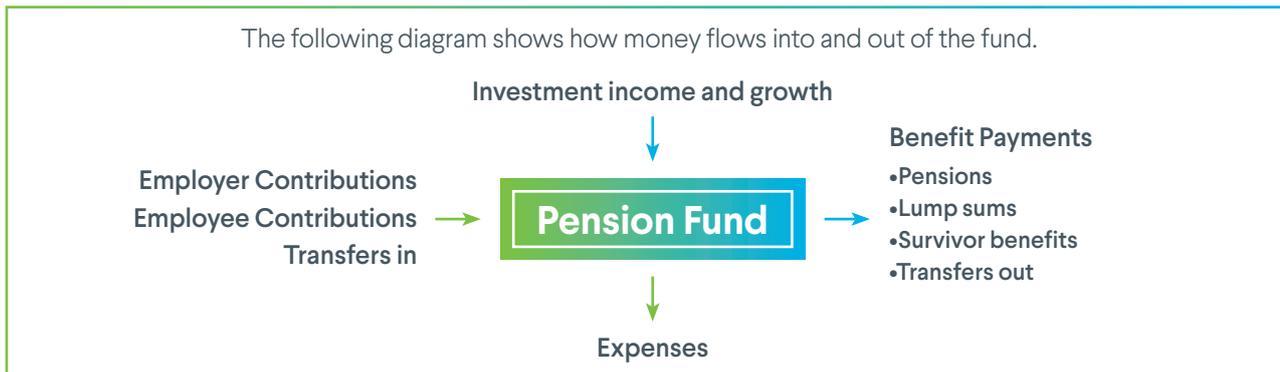
Bonds provide a regular income and are repaid in full at maturity. Gilts are issued by the UK Government and Corporates are issued by companies. Corporate bonds are perceived as being higher risk than gilts and therefore pay a higher interest rate. Index-linked gilts provide income and maturity payments which increase (or decrease) in line with inflation.

### Alternatives

Asset classes that add diversification by delivering returns in a pattern that differs from equities. Includes Hedge Funds, Infrastructure and Diversified Growth Funds (this latter group are funds which invest in a range of different assets).

# The Role of the Actuary

Your main objective when running a pension fund is to ensure that there are sufficient funds to pay for the benefits as they fall due and contributions are paid at an appropriate level.



**Your fund actuary will carry out regular actuarial valuations of the fund with the following objectives:**

- To comply with legislation (it is mandatory to have an actuarial valuation every three years);
- To monitor the ongoing health of the fund (i.e. do you have enough money to pay the pensions?);
- To recommend appropriate contribution rates for employers; and
- To monitor the actual experience of the fund against the assumptions made.

In order to carry out the valuation, assumptions need to be made about future experience. The most important decisions will be around the discount rate to use and the longevity assumptions. These feed into financial modelling to help inform decisions around funding strategies. At valuation time, your actuary will provide assistance in determining these assumptions and setting funding strategies.

## Definitions

### Discount rate

This is chosen to reflect the investment return that is expected on the fund. It is applied to each future benefit payment to determine the (discounted) value of the fund's liabilities. For example, if the fund is due to pay a benefit of £100 in one year's time, and the discount rate is 5% pa, the associated liability value is £95.

### Longevity assumptions

One of the greatest unknowns for a pension fund is how long benefits will be paid for. People are currently living longer than they did in the past. The extent to which improvements are occurring needs to be actively monitored. At Hymans Robertson we have created Club Vita to carry out this vital function.

### Funding strategies

These aim to target full funding for each employer over an appropriate time horizon by striking a balance between future employer contributions and future investment returns. The financial strength and risk profile of employers are key factors for a fund to consider when setting the strategies.

# LGPS boards

All LGPS funds are required to have a local pension board. The board's role is to assist in ensuring that funds are governed efficiently and effectively and that regulatory and best practice requirements are met.

The role of the local pension board is to assist the scheme manager (the administering authority) in securing compliance with:

- The scheme regulations
- Other governance and administration legislation
- Any requirements of the Pensions Regulator
- Additional matters, if specified by scheme regulations

The boards are required to have an equal number of representatives from employers and scheme members. They may also have other types of members, such as independent experts, but such members will not have a vote.

The law requires local pension board members to have knowledge and understanding of relevant pensions laws, and to have a working knowledge of the LGPS and its documentation.

## Knowledge and skills

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Finance officers will be well aware when finalising LGPS fund accounts that the CIPFA code of practice requires a statement that those responsible for the governance of the fund have the necessary skills. The CIPFA code of practice embeds the requirement to ensure those charged with pension scheme governance have access to the skills and knowledge to carry out their role effectively.

Members of local pension boards also have a statutory requirement to have knowledge and understanding of the law relating to pensions and any other matters specified in regulations.

Whereas the role of the pension committee usually involves carrying out a decision-making function, members of pension boards should focus on the processes involved in running the fund. For example, are policies and procedures up to date, are the requirements of the Pensions Regulator being met and is the fund following recognised best practice?

At a national level there is also a **Scheme Advisory Board**. This consists of representatives from across a broad spectrum of LGPS stakeholders. Its purpose is to encourage best practice, increase transparency and coordinate technical and standards issues by being reactive and proactive. Separate SABs exist for the schemes in England & Wales, Scotland and Northern Ireland.

Unlike local board members, there is no statutory requirement for decision makers on a Pension Committee or panel to have a particular level of knowledge on pensions law or LGPS matters. In order to comply with MIFID II<sup>1</sup>, however, there is a requirement for fund committees to provide evidence of their knowledge and understanding, to be classed as a "professional client". It would be impossible, therefore, for a pension committee to carry out its role effectively without such knowledge and understanding.

1 Markets in Financial Instruments Directive II

For this reason, CIPFA published technical guidance for Representatives and Practitioners in the public sector within a Knowledge & Skills framework (KSF). The framework outlines the required skills set for those responsible for pension financial management and decision making.

The SAB Good Governance Review has also recommended that members of Pension Committees should have a requirement to obtain the knowledge and understanding necessary to carry out their role effectively. This is not the same as being a pensions subject matter expert, it is more about having the skills to ask questions, seek advice and weigh up options.

With so much going on in the world of the LGPS, Pension Committee and Board member training has never been more important.

## The eight areas of the framework

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- Pensions Legislation
- Public Sector Pensions Governance
- Pensions Administration
- Pensions Accounting and Auditing Standards
- Pensions Services Procurement and Relationship Management
- Investment Performance and Risk Management
- Financial markets and product knowledge
- Actuarial methods, standards and practices

The framework is in the process of being updated and to help assist Pension Committees and Boards gain the right level of knowledge in these areas, Hymans Robertson has created an online learning tool – the [LGPS Online Learning Academy \(LOLA\)](#). This consists of a series of training videos and material covering the eight key areas above, as well as other topical areas. You may want to check that your Fund has a training plan in place and how the relevant skills and knowledge for yourself will be monitored and measured.

## Contact Us

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