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# LGPS Update





# What does a pension fund do?

- It collects contributions
- It pays pensions
- It administrates the pension system
- It hires investment consultants and managers
- It invests surplus cash

#### Pension schemes and their structures

- Defined contribution or DC
- Defined benefit or DB
- Public sector is Defined Benefit

## Types of funding

- DC Investment returns all contributions are invested until the member wants to retire - over time a fund is built up
- DB All surplus cash, after collecting contributions and paying out benefits is invested
- Pay as you go public sector government funds its departments – cash surpluses (after contributions and benefits paid) are returned to the Treasury



## What is the LGPS?

- A defined benefit pension scheme made under statute
- A funded pension scheme that uses investment returns to help pay pensions

- A single set of benefits for England and Wales
- Currently organised in 89 administration authorities/ funds

#### LGPS Overview

- Secretary of State has power to create a pension scheme for local government
- DCLG drafts the instruments setting out its terms
  - Legally binding statutory instruments
  - Guidance: some has legal force, some does not
  - CIPFA guidance given statutory force
- Statutory instruments give powers and duties
  - Administering authorities
  - Employing authorities
  - Scheme governance can be delegated to officers, committee or sub committee – but not cabinet
- It is not a pension scheme established by trust law so no trustees

# Statutory guarantee, what is it?

Members of the scheme have no direct rights against their employers or the administering authority for payment of their benefits – their entitlement is to have the appropriate fund applied to meet their benefits. However, the employers who contribute to each fund within the LGPS are obliged to fund it on a level sufficient to meet the benefits. To this extent, therefore, there is state guarantee for members' benefits. Michael Furness - UNISON counsel opinion

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#### **National board**

- By consensus of the board
- If consensus cannot be reached the employer and member representatives would be asked to give their views as groups.
- If decisions can't be agreed ultimate authority sits with minister

#### Sub committees of board

- Standards and Governance
- Administration and communications (technical)
- Investment and engagement
- Value for money
- Cost, benefit and contributions
- Membership of these committees will require transparency and accountability



#### **Local Boards**

- Regulation 106(1) of the Regulations specifies that each Administering Authority shall establish its own Local Pension Board with responsibility for assisting the Administering Authority:
- to secure compliance with: the Regulations;
- other legislation relating to the governance and administration of the LGPS; and
- the requirements imposed by the Regulator in relation to the LGPS, and
- to ensure the effective and efficient governance and administration of the LGPS.
- A local pension board shall have the power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions.



## **Local Boards membership**

- 107.—(1) Subject to this regulation each administering authority shall determine—
- (a) the membership of the local pension board;
- (b) the manner in which members of the local pension board may be appointed and removed;
- (c) the terms of appointment of members of the local pension board.
- (2) An administering authority must appoint to the local pension board an equal number, which is no less than 4 in total, of employer representatives and member representatives
- and for these purposes the administering authority must be satisfied that
- (b) a person to be appointed to the local pension board as a member representative has the capacity to represent members.



# What are the processes involved?

 Pooling of your assets into 'Common Investment Vehicles'

Pension funds must pool assets – pools must have no less than £25bn of assets under management and require projections on infrastructure investing

Consultation on new investment regulations

New investment regulations to support the government's pooling objectives – consultation ended 19<sup>th</sup> February

#### **UK Treasury – England/Wales Scaling Up**

- The criteria for the consultation which will seek proposals from the fund administration authorities, will include the following.
- Asset pools of no less than £30bn
- Transparent costs (this is progressive)
- Effective governance No alignment with scheme members no representation members
- Environmental, social and governance proposals for the asset classes
- Creation of Common Investment Vehicles (CIV's)
- We support the proposals to a limit on the grounds that more asset management will be done in-house, thus creating new public sector jobs while at the same time reducing costs to scheme members.

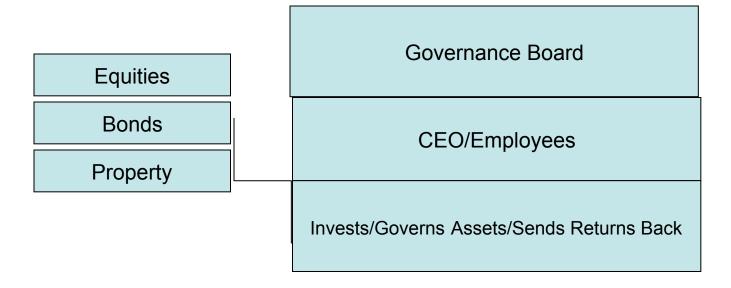
#### **LGPS & Infrastructure**

- Osborne "the creation of British Wealth Funds would revolutionise infrastructure investment. The current LGPS funds lack the expertise to invest in infrastructure, with only around 0.5% of £180bn assets invested in such projects. In countries with larger pooled public pension funds up to 8% of assets are infrastructure and 17% are housing and infrastructure".
- Cameron told the BBC's Andrew Marr Show: "I think sink housing estates, many built after the war, where people can feel trapped in poverty, unable to get on a build a good life for themselves, I think it is time with government money but with massive private sector and perhaps pension sector help to demolish the worst of these and actually rebuild houses that people feel they can have a real future in."
- Is the object of the LGPS paying pensions or replacing Treasury borrowing to fund infrastructure? So we need to be extremely cautious that the local government pension fund investment returns are not compromised by thoughts of compulsory investment in local or regional infrastructure from which the returns may be much less certain. And ask the simple question is it in the best interests of scheme members?

12

## **Common Investment Vehicles**

## Northern Powerhouse



Fund 1

Fund 2

Fund 1

Fund 1

Member funds collect contributions/pay pensions/invest into the pools

## **New Investment Regulations**

- Investment regulations are the written instructions on how an LGPS fund must invest – the rules of investing
- All pension funds in the UK/EU must invest in the 'best interests of scheme members' – the only scheme not to is the LGPS
- The Scheme Advisory Board, the Law Commission and UNISON have requested that the government apply the Investment Regulations applicable to all other pension funds in the UK and the European Union – our counsel opinion believes that the government is in breach of the EU Directive 41/2003 Institutions for Occupational Retirement Provision (IORP)
- The new draft regulations do not make your investment regulations compliant with the IORP Directive – we have asked for advice from the Legal department

# So what does the government say?

- "Having considered fully the recommendation made by the Kay Review and supported by both the Law Commission and the Government, Ministers are satisfied that the Scheme is consistent with the national legislative framework governing the duties placed on those responsible for making investment decisions"
- "The Secretary of State has made clear that using pensions and procurement policies to pursue boycotts, divestments and sanctions against foreign nations and the UK defence industry are inappropriate, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government".
- "This draft regulation places an obligation on the administering authority to consult on and publish an investment strategy statement, which must be in accordance with guidance from the Secretary of State. The statement should demonstrate that investments will be suitably diversified, and it should outline the administering authority's maximum allocations for different asset classes, as well as their approach to risk and responsible investing."
- "Only a very small proportion of Local Government Pension Scheme assets are currently invested in infrastructure; pooling of assets may facilitate greater investment in this area. Proposals should explain how infrastructure will feature in authorities' investment strategies and how the pooling arrangements can 15 improve the capacity and capability to invest in this asset class."

## Costs are a BIG problem

- No LGPS fund knows its true costs
- England/Wales moving towards cost transparency
- Improved reporting has pushed up investment costs
- The cost of running the scheme increased by a mind-boggling 42% in the past year, to £810m
- But these are not the true costs project to bench mark to Dutch data



## Why does transparency matter?

- Informs improved decision making
- Helps achieve the best outcomes possible for members/sponsors
- An organisation that is transparent is perceived as trustworthy
- Growing demand from consumers, participants, institutional investors, regulators and authorities (including SAB's)
- Essential for fairer, safer and more efficient Financial Services markets

### A simplified model for a Pension Fund Value Chain – Costs

Total Cost of Ownership	Admin Charges	Investment Management Charges	Custody Charges	Equity Trading Charges	Fixed Income Trading Charges	Alternatives Trading Charges	Stamp Duty & Taxes	FX Charges
Value-chain participant	'Wrapper' or <b>I</b> Pension <b>I</b>	Investment I Managers I	Custody Banks	Brokers	Brokers	Brokers	i . i	Custody Banks
Data Source	Fund Peported in Pension Pension Fund (PF) Annual Reports F	-Reported in PF Annual Reports, but only in aggregate for all Investment Managers (IMs) -Granular data should be reported but never is	-Sometimes reported in PF Annual Reports -In theory this should be obtainable on request from Custodian	-Commission data is collated by IA in the UK but is not reported in PF Annual Reports -Spread is not reported or collected - Both should	PF Annual Reports -Should be obtainable from IMs	-Fee data (spreads and commission) is never reported in PF Annual Reports -Should be obtainable from IMs	-Can be calculated from turnover data but is not generally reported in PF Annual Reports	-Not found in PF Annual Reports -Should be obtainable from Custodian
Comment	Readily available for NL schemes	Investment Managers will resist collation and publication of granular data	Charges can also include Stocklending , FX and interest income	obtainable Infvestrient Managers required to publish this data in NL by FTK	Some Investment Managers prepared to disclose this information but most charges are based on estimates	Recent disclosures prove work still needed in this area	Investment Managers routinely blame the Government for this charge, but it is only significant if churn is high	Now subject to scrutiny in the US and Ireland after alleged abuses exposed

## **Conclusions**

- Scaling up the assets and controlling costs will be very beneficial for scheme members and sponsors
- Having a government direct investing and give them powers of intervention – is a bad thing and a breach of law
- Investing your money is privatisation on a large scale is a bad thing for scheme members
- The only prevention for this is to have the IORP Directive applied – i.e. must invest in the best interests of scheme members
- Legal remedy is a complaint to the EU Commission/Judicial Review
- Consider what the reaction of the current government would be if they lost?



# **Campaign actions**

- Regions and service groups have been asked to engage with branches to ensure they are aware of our position and they respond to the consultation
- The issues of pooling and new investment regulations have already been referred to the Legal Department
- Press and parliamentary briefings produced
- Parliamentary Petition
- Consultation response for branches and regions to submit
- UNISON LGPS Board members involved requests made for information