TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 9

TEESSIDE PENSION BOARD REPORT

19 JULY 2021

DIRECTOR FINANCE – IAN WRIGHT

Update on Current Issues

1. PURPOSE OF THE REPORT

1.1 To provide Members of the Teesside Pension Board (the Board) with an update on current issues affecting the Pension Fund locally or the Local Government Pension Scheme (LGPS) in general.

2. RECOMMENDATIONS

2.1 That Members note this report.

3. FINANCIAL IMPLICATIONS

3.1 There are no specific financial implications in respect of the information contained in this report.

4. REVIEW OF THE COST CONTROL MECHANISM

4.1 In 2014 and 2015 all the main public service pension schemes were significantly changed, with normal retirement ages typically linked to the state pension age going forwards and schemes moving from being final salary to (revalued) career average salary schemes. When the changes were introduced the government put in place a mechanism for checking whether the cost of providing each scheme was falling outside of an agreed cost envelope. The intention was to ensure if the schemes became more expensive some of this cost could be borne by the scheme members and not just the taxpayer and, conversely, if the schemes became cheaper than anticipated, scheme members' benefits or contributions could be adjusted to ensure they were still getting equivalent value from their scheme.

4.2 The method for carrying out this check is known as the cost control mechanism and an assessment was intended to be carried out after each valuation (every 3 or 4 years depending on the scheme). The cost control mechanism 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 are increased/reduced to bring the assessed costs back to the original level. Unfortunately, the first assessment carried out into the unfunded public service pension schemes following their 2016 valuations produced what many consider to be a perverse outcome, where member benefits (and so employer contributions) were due to increase despite these benefits already being generous, and against a backdrop of increasing disparity between public and private sector pension provision and a difficult economic climate. As it transpired, and scheduled increase to benefits has been put on hold until the outcome and cost of rectifying the discrimination revealed following the McCloud case has been determined. In the meantime the government asked the Government Actuary to carry out a review into how the cost control mechanism operates.

4.3 The Government Actuary has provided a final report to HM Treasury, which has issued a consultation document proposing three changes to the cost control mechanism:

- Moving to a reformed scheme only design: to remove any allowance for legacy schemes in the cost control mechanism, so the mechanism only considers past and future service in the reformed schemes. This ensures consistency between the set of benefits being assessed and the set of benefits potentially being adjusted;

- Widening the corridor: to widen the corridor from 2% to 3% of pensionable pay. This aims to achieve a better balance between stability and responsiveness of the cost control mechanism; and

- Introducing an economic check: currently the mechanism does not include changes in long-term economic assumptions and therefore cannot consider the actual cost to the Government of providing the pension benefits. The Government proposes introducing an economic check so that a breach of the mechanism would only be implemented if it would still have occurred had the long-term economic assumptions been considered.

The full consultation document can be accessed here: https://www.gov.uk/government/consultations/public-service-pensions-cost-control-mechanism-consultation

4.4 The impact on the LGPS if these proposals took effect is currently unclear, this is how actuarial firm Hymans Robertson assessed the position:

"The cost control mechanism applies to all public sector pension schemes, including the LGPS. Therefore, the consultation proposals, if implemented, will apply to future LGPS cost cap valuations. The "Reformed scheme only" and "Widened corridor" proposals can be relatively easily applied to the LGPS. However, the "economic check" proposal is slightly more complicated.

In the LGPS, employer contribution rates are set locally and are significantly influenced by the level of asset returns achieved to date and the future level of expected investment returns, both of which vary by investment strategy. However, it is proposed that the "economic check" is based on the same discount rate used to value the unfunded schemes – future expectations of growth in UK Gross Domestic Product (GDP). Whilst the consultation acknowledges this difference, the Government Actuary and Government believe that the difference is not significant enough to warrant any different treatment. This is an opinion we would disagree with, mainly because LGPS funds invest globally so we do not believe UK GDP is a suitable proxy for future expected LGPS investment returns.

The LGPS in England & Wales is also slightly different to other public sector schemes as there exists a Scheme Advisory Board (SAB) cost control mechanism which runs alongside the Treasury mechanism (further detail can be found on the SAB's website). The existence of this additional mechanism seeks to recognise the unique nature of the LGPS in the world of public sector pension schemes (having assets to pay the liabilities). At the time of writing there is no detail on whether the SAB mechanism will be amended in line with any of the consultation's proposals."

5.1 **CLIMATE CHANGE DISCLOSURES**

5.2 The government published a response to its January 2021 consultation on "Taking action on climate risk: improving governance and reporting by occupational pension schemes" on 2 July 2021. The consultation response can be found at the following link: https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes#chapter-2-scope-and-timing

5.3 The outcome of the consultation confirmed that by 1 October 2021, private sector schemes with assets in excess of £5 billion, and by 1 October 2022, private sector schemes with assets in excess of £1 billion, will need to have appropriate governance arrangements in place to identify, assess and manage climate-related risks and opportunities and be preparing to publish annual reports setting out climate-related metrics, targets and transition plans in line with the Task force on Climate-related Financial Disclosures (TCFD).

5.4 The new requirements are expected to become law in the coming months.

5.5 Trustees of schemes in scope of the new requirements should now take steps to ensure that they will be in a position to comply with the new requirements by the relevant date. The government has made it clear that all trustees are expected to take action to address climate risk in line with their fiduciary duties.

5.6 None of this directly applies to the LGPS but the government has indicated that a consultation will be issued soon (followed by regulations) to bring the LGPS into line with private sector schemes in this area.

5.7 The Fund is in ongoing discussions with Border to Coast and with its partner Funds in Border to Coast to investigate whether there is an opportunity for collaboration or joint working in measuring carbon exposure and meeting the TCFD reporting requirements. The Fund has also made initial contact with all its investment managers to understand what reporting details will be initially available in respect of each of the Fund's investments.

6. NEXT STEPS

6.1 Further updates will be provided periodically.

CONTACT OFFICER: Nick Orton – Head of Pensions Governance and Investments

TEL NO.: 01642 729040