

Conflicts, governance and the LGPS

Michael Hayles and **Rory Trust** explore the challenges for local government of working with The Pensions Regulator to achieve public sector pensions reform

Next month, the Department of Communities and Local Government (DCLG) plans to lay down regulations for the Local Government Pensions Scheme (LGPS). The regulations follow a consultation made further to the Public Service Pensions Act. It is widely hoped that they will finally provide some much-needed detail to the picture of public sector pensions reform first sketched out in the *Hutton Report* back in 2011.

Many will be keen to get some clarity on The Pensions Regulator's role in monitoring conflicts of interest within the new 'Pensions Boards'.

These boards will take on a similar role to that of trustees in private sector schemes, assisting the body responsible for managing the scheme with good administration and governance.

In his briefing paper on the topic, Jeff Houston, head of pensions for the Local Government Association, describes Pensions Boards as taking 'a compliance and scrutiny role' with a responsibility to ensure that the scheme manager, which has a more 'hands-on, management and investment function', is complying with its responsibilities.

However, there are inherent tensions and conflicts within the LGPS system for Pensions Board and scheme managers. The most obvious is between the prospect of raising employer contributions as liabilities increase and a local authority's ambition to lower them – ultimately to reduce demands on taxpayers.

The reformed public service schemes will be required to undertake actuarial valuations in order to set employer contribution levels to ensure both the solvency of

the fund and the long-term cost efficiency of the scheme.

Part of the Pensions Board's role is to ensure these statutory requirements are met, in addition to any requirements imposed by The Pensions Regulator.

A conflict of interest will arise if any member of the board has 'a financial or other interest which is likely to prejudice' them meeting the set requirements.

The risk of such a conflict seems high given the funding of the LGPS and the difficult balance between meeting scheme

requirements, The Pensions Regulator will provide guidance by issuing improvement notices.

The regulator is also obliged to alert the scheme manager if it has reasonable grounds to suspect a member of a Pensions Board has a conflict in relation to the investment of assets under the scheme.

It is difficult to see how this reporting structure and scrutiny role can be met if the scheme manager and Pensions Board constitute largely the same people.

In addition to conflicts, the other area

relation to the scheme to which they are appointed.

However, members of the Pensions Boards may well owe fiduciary duties to the scheme employer, for example, as senior officers.

The regulator does not have the power to suspend or remove members of the Pensions Boards directly – this is up to the scheme manager. But it can issue an improvement notice.

The regulator also has the power to appoint someone to assist the Pensions Board if it sees fit.

This has happened in the private sector where independent trustees have been appointed when the regulator believes there's a risk of a conflict of interest or additional skills are required on the board. Pensions Boards must pay attention to the advice of such an appointed person.

Ultimately, the scheme manager is responsible for meeting the requirements of good governance, so it will be interesting to see if such 'special measures' affect the responsibility of the Pensions Boards for their decisions.

For example, if a manager is deemed to have failed in this regard, weight is likely to be given to the fact that they were following the directions of a person appointed by the regulator.

While we wait for more clarity and detail from DCLG, one thing is clear: The Pensions Regulator has a pivotal role to play in implementing the final composition of public sector pensions reform. ▀

Michael Hayles and Rory Trust are lawyers from the public sector pensions team at UK law firm, Burges Salmon

There are inherent tensions and conflicts within the LGPS system for Pensions Board and scheme managers

liabilities and delivering public services.

It is not difficult to contemplate a scenario where a Pensions Board member feels stuck between following actuarial advice, potentially raising local authority contributions, and funding a local project which would require local spending.

The DCLG consultation invited comments on whether a local authority committee should be able to fulfil such a role.

Even if the final regulations preclude such an arrangement, the selection of the Pensions Board by the scheme manager – which in the case of the LGPS will be the administering authority – will be a difficult one. They need to ensure that the board is made up of equal numbers of employer and employee members, while also being satisfied that there is no conflict of interest.

Should the selection fail to meet these

that needs more clarity is governance – particularly in relation to the Pensions Board's 'duty of knowledge and understanding' (similar to that placed on trustees in the private sector) which was imposed by the Public Service Pension Act.

Currently, the statute prescribes a level of knowledge that is 'appropriate for the purposes of enabling the individual properly to exercise the functions of a member of the Pensions Board'.

This will be one of several areas where the regulator is obliged to issue a Code of Practice.

These codes will provide welcome detail, but what may be less well-defined is the effect of any 'fiduciary' duties in relation to the Pensions Boards.

These are a series of common law duties which apply to trustees that will not apply to Pensions Boards, at least not in