**Agenda Item No: 8 Appendix 2**

**Northamptonshire and Cambridgeshire Pension Funds**

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| Date: | 23 May 2014 |
| Prepared for: | Northamptonshire and Cambridgeshire County Councils as Administering Authorities to the Northamptonshire and Cambridgeshire Pension Funds respectively |

# Consideration of LGSS Service Level Agreement and Governance Proposition

## 1. Introduction and Background

This report has been prepared for the members of the Pension Fund Boards ("the Pension Fund Boards") for the Cambridgeshire and Northamptonshire Local Government Pension Scheme Funds ("the Funds") to assist in their consideration of the proposals put forward by the LGSS Managing Director in relation to a Service Level Agreement to support the current arrangements. The paper has been developed with the assistance of Eversheds (as Legal Advisers) and Aon Hewitt (as specialist Benefit Consultants) both of which are acting in their capacity as advisers to Cambridgeshire and Northamptonshire County Councils as administering authorities of the respective Funds.

## 2. Structure of the LGSS Joint Committee

LGSS is established as part of the arrangements for shared services, a key element of the governance arrangements being a joint committee established pursuant to an agreement between Cambridgeshire County Council and Northamptonshire County Council in accordance with the provisions of sections 101 and 102 of the Local Government Act 1972. The terms of reference of the joint committee provide for each of the two local authorities to appoint three members to the joint committee as their nominated members. Substitute members are permitted. Each of Cambridgeshire County Council and Northamptonshire County Council may nominate one or more substitute members to attend any meeting in place of an appointed member from that local authority subject to notification being given to the Secretary to the Joint Committee before the start of the meeting.

LGSS is not a legal entity in its own right, separate from Cambridgeshire County Council and Northamptonshire County Council as the local authorities that have established it. Therefore, LGSS does not have the capacity to enter into contracts or own property or employ staff in its own right. If it needs to take such actions, it would need to act through one of the local authorities. Cambridgeshire County Council and Northamptonshire County Council could also decide to establish a new legal entity such as a company.

Each of Cambridgeshire County Council and Northamptonshire County Council provide on their website details of their members on LGSS. However, these may need to be updated, as they differ from details recorded in minutes of recent meetings of LGSS.

According to the website of Cambridgeshire County Council as at March 2014, the joint committee representatives of Cambridgeshire are Councillor Paul Bullen, Councillor Steve Count, and Councillor Ian Manning. The substitutes are Councillor Ian Bates, Councillor Barry Chapman, Councillor Mac McGuire, and Councillor Matthew Shuter, Substitutes to be confirmed are Councillor Peter Ashcroft, Councillor Simon Bywater, Councillor Maurice Leeke, Councillor Amanda Taylor, Councillor Michael Tew.

According to the website of Northamptonshire County Council (as at March 2014), the joint committee representatives of Northamptonshire County Council are Councillor Andrew Langley, Councillor Bill Parker and Councillor Chris Stanbra. However, minutes of the LGSS meeting on 8 August 2013 identify the representatives of Northamptonshire County Council as Councillor Graham Lawman, Councillor Bill Parker and Councillor Bob Scott.

Cambridgeshire County Council and Northamptonshire County Council also have separate roles as 'administering authorities' in respect of their own LGPS Fund. Each Council has its own delegated Pension Fund Board for its Fund. There is some cross over of membership of the LGSS Joint Committee and the Pension Fund Boards:

- Councillor Steve Count - Cambridgeshire, and
- Councillors Graham Lawman and Bob Scott - Northamptonshire.

The local authorities involved in LGSS must always act within their powers and that includes acting reasonably, including making sure that they do not fetter their discretion. They must be able to withdraw from the arrangement if they decided that this would be appropriate or necessary to do so. It would be reasonable to take account of practical matters, for example requiring a period of notice and reimbursement of costs but the local authorities must be able to withdraw.

It must also be recognised that section 101 of the Local Government Act 1972, which gives local authorities the power to delegate functions and to arrange for the joint discharge of functions, says at section 101(4) that "*any arrangements made by a local authority or committee under this section for the discharge of any functions by a committee, sub-committee, officer or local authority shall not prevent the authority or committee by whom the arrangements are made from exercising those functions*".

### 3. Background to LGSS Pension Services

In July 2011, the Cambridgeshire and Northamptonshire Pension Fund Boards individually considered a report from the LGSS Head of Pensions highlighting the change in officer structure and how the administration of the respective Funds under the umbrella of LGSS would operate. Both Pension Fund Boards agreed to this approach with appropriate acknowledgement that both Councils, as administering authorities, retained overall control of the Funds and only appropriate functions would be delegated to officers. It was also noted at the Cambridgeshire Pension Fund Board that any disagreement between LGSS and the Pension Fund Boards would result in the need for those parties to meet to agree a way forward. It is worth noting that, since those reports, we do not believe it has been necessary for any such joint meeting to take place. Further it was noted at that same meeting that the relationships would benefit from reciprocal service level agreements to be put in place.

### 4. Administering Authority Responsibilities

Cambridgeshire County Council and Northamptonshire County Council each have retained their separate roles as 'administering authorities' in respect of their own LGPS fund. Therefore each Council retains ultimate responsibility for the management, administration and investment of its respective Fund, with the administration being delivered by LGSS.

Under Regulation 4(5) of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, any costs, charges and expenses incurred administering a pension fund may be paid from the fund (with some limited exceptions).

Therefore each Council has the express power to pay LGSS's administration costs from the Fund assets.

## 5. Other LGPS Shared Services

Though shared services have been in place for a number of years within the local government environment, it is a relatively new concept in relation to the administration of Local Government Pension Scheme funds and related duties. We understand the only other comparable arrangements currently in place in England are as follows:

- Lancashire and Cumbria – Lancashire County Council (who administer the Lancashire Pension Fund) took on the administration of the Cumbria Pension Fund. The investment responsibilities remain with Cumbria County Council,
- London Boroughs of Wandsworth, Camden and Merton – Wandsworth now manage the shared service for all three funds (administration only – not investments).
- Surrey and East Sussex – Surrey manage the shared service for both funds (administration only – not investments)
- Devon and Somerset (Peninsula pensions) – Devon manage the shared service for both funds. This arrangement appears to have just gone live late in 2013 and so there is very little information publicly available though it does appear to be for administration services only (not investments)

It is worth noting that the Cumbria and East Sussex pension administration services were outsourced to private contractors immediately before moving to these shared service arrangements.

Clearly any local authority based shared service arrangement will be set up on its own individual basis, with specific circumstances that will need to be taken into consideration in the partnership. However, the arrangements relating to the management of LGPS pension funds could be considered as being unique due to the fact that the costs for administering LGPS funds can be paid from those pension fund assets.

There are clearly a number of key benefits of shared service arrangements including:

- Ensuring efficiencies through economies of scale
- Opportunities for improving quality due to the wider knowledge base

whilst not having to outsource services to private contractors. However, to ensure the proper management of such services, it is good practice to ensure the responsibilities of all parties are articulated in writing, for example in a service level agreement, and that there is an appropriate governance structure in place to facilitate ongoing monitoring and decision making. It is for these reasons that we commend LGSS, Cambridgeshire County Council and Northamptonshire County Council for considering these matters.

This report considers some of the areas highlighted above in more detail, and in particular, provides comment on the service level agreement that is being proposed.

## 6. Decision Making – Managing Conflicts of Interest

Due to the fact that some Pension Fund Board members are also members of the LGSS joint committee and some officers of the Councils have responsibilities both as Council officers and as officers with responsibilities for delivering LGSS pension or other services, it is worth highlighting the potential for conflicts of interest and how any potential conflicts can be managed.

*6.1. Managing Committee Member Conflicts:*

As noted above, Councillors Count, Lawman and Scott are members of LGSS joint committee as well as members of their respective Pension Fund Board.

Local authority elected members must always ensure that they take decisions reasonably and on the merits of the decision, having taken account of all relevant factors. They must ensure that they can approach decisions with an open mind. They must therefore not participate in decisions in which interests relating to the business concerned affect their ability to approach the decision impartially or will cause them to predetermine the decision.

The Localism Act 2011 imposes particular obligations on elected members to register their disclosable pecuniary interests, as defined in the Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012, and not to participate in business in which they have a disclosable pecuniary interest. Failure to comply with these obligations can amount to a criminal offence. The elected members' Code of Conduct of the local authorities also impose obligations on members in this respect.

It seems unlikely that membership of the Pension Fund Board would give a councillor an interest which would amount to a disclosable pecuniary interest but there may be occasions when this might affect the ability of a councillor to take an impartial and unpredetermined decision relating to LGSS, and vice versa. Therefore, the Councils will need to ensure that the Pension Fund Board members who also represent the Councils on the LGSS joint committee recognise the importance of addressing such potential conflicts and, where necessary, that they make appropriate use of other Pension Fund Board members and substitutes.

*6.2. Managing Officer Conflicts:*

It is standard practice for senior officers of local authorities to provide advice to committees set up by their local authorities and this includes joint committees such as the LGSS joint committee. In this situation, officers could be providing advice to the LGSS joint committee in addition to the Pension Fund Boards.

Therefore, senior officers are usually familiar with the need to avoid conflicts of interest, both conflicts between their personal interests and those of their local authority and, in situations involving joint arrangements, between the interest of their own local authority and/or pension fund and those of the LGSS joint committee. In the case of the Councils, the officers clearly need to be aware of the Council's specific interests as 'administering authorities' in relation to the Funds.

It should be possible to make provision for the officers involved with the LGSS joint committee to share responsibility for advising it, so that if one officer will be affected by a conflict of interest or a potential conflict of interest between the Pension Fund Boards and LGSS, an equivalent officer from the other authority will be able to provide the required advice to the Pension Fund Boards. If circumstances arise on which all officers at both Councils would have a conflict of interest, officers can make arrangements to obtain external legal advice for the Pension Fund Boards. This will be especially important for the officers working directly as part of LGSS who will need to take care to be vigilant about potential conflicts of interest, in particular including any statutory officers involved in advising the LGSS joint committee members. These officers will need to make sure they declare any interests and comply with the officer Code of Conduct.

In particular, the monitoring officer and the officer responsible for the proper administration of the financial affairs of each Council have responsibility for taking action to prevent or address unlawful action by their authorities. The Councils will need to determine who will take on these responsibilities in respect of the joint committee and how the officers at the other Council will comply with their obligations under these circumstances. For example, if a legal officer has been involved in advising one Council in its capacity as an ‘administering authority’ on, for example, issues relating to the charging structure within the LGSS SLA, it might not be appropriate for the same officer to advise the LGSS joint committee on the same issue. In those circumstances a legal officer from the other Council should advise the LGSS joint committee or external advice should be sought (as has been the case in this circumstance).

LGSS has its own terms of reference. These include provision for the type of matters that would be expected to be included in an agreement between local authorities for administrative arrangements. There are provisions relating to membership; frequency of meetings; appointing the chairman and vice chairman; voting at meetings; procedures at meetings; contractual arrangements; provision of support services to the committee; delegated functions. These terms of reference for LGSS allow for delegation to a sub-committee or an officer. It may be helpful from time to time for LGSS to set up sub-committees to deal with specific matters.

## 7. Proposed Service Level Agreement

A service level agreement between LGSS and each Council as an administering authority would complement the general administrative arrangements of the LGSS joint committee structure and would provide a framework to the provision of LGPS specific administration services, recognising the specific administering authority duties of each Council. As a matter of good governance, the Councils as administering authorities should have such an agreement in place with whoever is providing such services so that there is clarity over the services being provided, in what capacity and for what cost.

We note there are some drafting errors in the current draft SLA that need attention and will feed these back to the Task and Finish Group. In particular, we note there are references to Employer Services, albeit with no information relating to the charging of these services. As these relate to services that would not normally be charged to a Pension Fund, it should be considered whether all references to Employer Services should be removed and incorporated into a separate SLA for use by employers.

We also note that the start date is shown as 1 April 2013, which we assume will be amended to a future date.

The draft SLA contains no express provisions dealing with the termination of the administration services. Whilst termination could be dealt with in the context of the wider shared services arrangements, from a governance perspective it would be useful to have provisions dealing with what would happen in the services did cease, in particular dealing with the return of confidential Fund information.

### *7.1. Charging Structure*

The proposed charging structure is included in Schedule 1 of the SLA.

This will be the major element of services being provided to the Councils as administering authorities and, as mentioned above, these costs can be recharged to each Fund.

The key principles relating to this are that each Fund will pay a proportion of the total cost based on the number of LGPS pension records that they have. Further, where the cost for that Fund decreases from the previous year (for example due to efficiencies), the Annual Fee will be adjusted to take account of 50% of the cost savings. Note that there is no reciprocal mechanism in the draft SLA for where the costs have increased (i.e. the Annual Fee will not be reduced to take account of 50% of the cost increase).

Examples of the impact of this approach have been prepared and can be shared with the Task and Finish Group showing how this could progress through the years in various circumstances including:

- New pension funds joining LGSS
- A pension fund leaving LGSS
- Ongoing efficiencies.

We should highlight that we do not have particularly strong views in relation to the charging structure in the draft SLA so have generally used this report as an opportunity to highlight alternative options and considerations for the Pension Fund Boards when considering the proposed charging structure.

### *7.2. Other LGPS Shared Service Charging Structures*

Shared service charging structures of other LGPS pension funds tend to be commercially sensitive and as a result are generally not publicly available. Further most LGPS shared service arrangements are relatively new. Anecdotal evidence from various sources, including Council reports and annual report and accounts, are that the fee structures for other LGPS shared services appear to cover a range of methods including:

- Actual costs shared on a proportion of membership basis, but with the potential to recharge additional costs when a Fund ceases or an additional cost/alternative charging mechanism where a Fund is considered less efficient at the point of take on
- A fixed lump sum cost with the potential to agree additional charges if additional work is required
- A cost per member approach.

These methods demonstrate a range of approaches with different elements of risk associated for the various parties. For example, a fixed lump sum cost or cost per member approach has a greater likelihood of the founder authority making a loss or a profit from the recharge, and conversely the Fund paying less or more than the actual cost of administration, albeit it will be relatively simple to administer. The approach being proposed by LGSS as part of their SLA does not appear to have been used in any other LGPS shared service arrangement to date. However it has to be acknowledged there are a number of other arrangements and each appears to have a unique charging structure.

### *7.3. Key observations in relation to this charging structure include:*

We provide comments on the proposed charging structure in three parts below.

<u>a) Method of proportioning costs:</u>

- Using the LGSS pension service cost as the starting point for the recharge results in a true cost recharge, removing the concern of accuracy of set costs. It is also provides LGSS with an opportunity to simplify the accounting of service charges.
- There will likely be several alternative methods as to how these costs are then proportioned between Funds. Using the proportion of records methodology to split the costs appears to have been used elsewhere. It is fair to note that each Fund will have its individual proportion of active to deferred to pensioner/dependant records and each type of record will have a different cost associated with its administration (indeed within each category there will be a wide range of costs). Further some Funds might need less administration for certain categories (for example, due to greater proportion of less complex full time employees). Accordingly, there will undoubtedly be some cross subsidisation from one Fund to the other Fund. However it would be extremely difficult to identify and quantify this. A more scientific (and potentially accurate) method of proportioning could be developed but will likely be open to criticism in relation to how any weightings are calculated due to the fact that Funds profiles are so individual.

- This proportioning of costs will result in Cambridgeshire Pension Fund being subject to a greater proportion of the cost than Northamptonshire which has fewer records. This appears a reasonable approach.
- However, it equally means that any unique Fund specific costs will be shared amongst all Funds. For example:
  - additional initial work due to taking on a new Fund (e.g. moving their existing systems to LGSS systems, data cleansing, project management)
  - an investment in a system which may or may not be wanted by all participating Funds
  - a Fund having a particularly high proportion of employers or issues with receiving data from those employers.
- Further, a loss of any LGSS Funds could result in an increase in costs due to losing economies of scale (i.e. less scheme member records to share out the total costs), but again this appears reasonable and (to a degree) unavoidable.

<u>b) Recharge of reduction in cost:</u>

- The proportioned cost is then adjusted in accordance with any change in cost for each specific Fund, with any reduction in cost year on year resulting in a payment of 50% of the reduction to LGSS from the Fund.
- This payment is in effect resulting in an adjustment to the Annual Fee charge for each Fund where LGSS service costs reduce. However it is worth noting that any decrease in costs may not directly be as a result of the actions of LGSS. Examples of circumstances where a decrease in cost (i.e. resulting in the additional charge to the Fund) might take place include:
  - ongoing efficiencies due to smarter working or better systems ,
  - reduced costs due to more Funds joining LGSS resulting in economies of scale ,
  - a change in legislation resulting in easier or less administration.
- This 50/50 part of the charging methodology therefore introduces a new element of cost for each Fund. In other circumstances such as an outsourcing to a private sector contractor, ongoing efficiencies often result in greater reward to the contractor albeit this is generally achieved through a fixed price arrangement with any efficiencies resulting in a higher profit margin. The added complication in this situation is that the 'business' is the Council, and much of the investment to put LGSS Pension Services in this position is as a result of investment that has, to date, been recharged to the respective Pension Funds (i.e. additional project costs as a result of converging the pension teams). There may, therefore, be an argument that any future benefits should fully flow back to the respective Pension Funds, rather than LGSS (i.e. the Councils). A contrary view might be that the creation of LGSS by the two Councils (which will naturally have resulted in some additional costs to those Councils) was the foundation for the merging of the two pension teams into LGSS Pension Services and without that initiative, the Pension Funds would not be benefiting from any efficiencies.
- A further factor that should be considered is that the SLA does not include any mention of a reciprocal 50/50 mechanism should there be an **increase** in the LGSS service cost i.e. should LGSS effectively reduce the cost to each Fund if this were to occur? This might be as a result of situations such as:
  - additional initial work due to taking on a new Fund (e.g. moving their existing systems to LGSS systems, data cleansing, project management)
  - losing economies of scale when an existing Fund leaves LGSS
  - change in legislation resulting more complex calculations for scheme members
  - an investment in a system which may or may not be wanted by all participating Funds.

- It is noted that there is no mechanism included in the SLA for how the calculation shall be adjusted if the service were to begin or cease part way through a year. It is possible that this is not necessary, but may merit further consideration.

c) Other general points in relation to the charging structure

We understand that some LGPS administering authorities that join LGSS in the future may not wish to use all LGSS pension services (for example, some may wish to retain their own investment services). The proposed charging structure will need to be customised for those Funds and, at that point, Cambridgeshire and Northamptonshire County Councils (as administering authorities) should be party to those discussions to ensure there is no detrimental impact on the recharges to their Funds. Further it may be worth considering if there is a chance that LGSS may enter into a different charging structure with another Fund (perhaps a fixed cost or the 50/50 recharge mechanism might be negotiated to an alternative proportion), which might then indirectly impact the recharge of costs to the Northamptonshire and Cambridgeshire Pension Funds. We would recommend that this is subject to ongoing monitoring as new customers join the LGSS Pension Service.

## 8. Governance Arrangements

We believe this would be a valuable addition to the existing governance structure for both Funds would be the creation of a Joint Sub-Committee or Working Group to manage the relationship between the Pension Fund Boards (working jointly) and LGSS. This would provide an opportunity for matters to be considered in a more efficient and timely manner, whilst not necessarily having to meet on a particularly frequent basis. Any such structure need not take away from final decisions and responsibilities being retained by the respective Pension Fund Boards.

We would recommend any such structure should be made up with individuals who are not members or substitute members of the LGSS joint committee and that the potential conflict of interest for officers is acknowledged in the development of reports to the Joint Pensions Sub-Committee or Working Group.

We would be pleased to work with the Pension Fund Boards to work with officers in developing the terms of reference for such a Sub-Committee.

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