Committee and date	Item / Paper
Pensions Committee 9 September 2009 10am	**11** Public

CONSULTATION ON THE LOCAL GOVERNMENT PENSION SCHEME - DELIVERING AFFORDABILITY, VIABILITY AND FAIRNESS

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Summary

This report explains that this is an informal consultation initiated by the Department for Communities and Local Government (DCLG). It begins a series of steps to consider some possible amendments which initially focus, for reasons of Scheme stability and viability, on the 2010 Scheme valuation exercise.

Recommendations

A. To agree to Officers sending the letter at **Appendix A** as a response to this consultation.

Report

The Consultation

1. The Department for Communities and Local Government (DCLG) aims to ensure that the Local Government Pension Scheme (LGPS) remains affordable, viable and fair for employees, employers and the taxpayer. Earlier this year, DCLG put in place the cost-sharing regulations. DCLG has now started informal consultation on other ways to ensure LGPS funding stability and viability. This consultation closes on 30 September 2009.

2. DCLG is concerned about the likely effect of current stock market turbulence on the results of the 2010 LGPS valuation, which in turn is likely to have a consequential effect on employer contribution rates. DCLG considers, therefore, that action should be taken now to try to counter funding risks that might adversely affect costs to employers

and taxpayers. In addition, DCLG considers this a sensible time to realign employee contributions of higher-paid employees.

3. DCLG proposes two ways in which to stabilise LGPS costs arising from the 2010 valuation:

   i. an amendment to the LGPS Administration Regulations to require each fund actuary to take full account of the affordability of employer liabilities to pay pensions and to meet liabilities at each actuarial valuation **(the financing plan).**

   ii. the administering authority to be given the ability to set a long-term funding target that is not 100 per cent. This approach would ensure consistency with an administering authority's funding objectives as set out in the funding strategy statement **(local funding targets)**.

4. DCLG considers that both these approaches would result in new employer contribution rates being set at each valuation at such a level to ensure that, over time, the fund is fully able to meet all employers' liabilities. They would also be flexible enough to reflect the individual circumstances of each LGPS fund, the long-term constitutional permanence of local government, its employer covenant and its statutory basis.

The financing plan

5. DCLG proposes that, instead of administering authorities putting in place a recovery plan to make good all of the past service deficit, which can impose significant short-term cost pressures on employers during economic downturns, each authority would prepare a financing plan to demonstrate how, over the short, medium and long term, it will fund pension fund liabilities. The financing plan would be part of the funding strategy statement and would:

   i. detail and determine local future income streams

   ii. detail how it is proposed to manage the funding of long-term liabilities (taking a prudent approach based on reasonable, reliable assumptions and professional advice)

   iii. take into account local budgetary constraints and recognise the reality of local resource and other parameters within which each fund must operate.

6. The detail of the financing plan would be set out in regulations or authoritative guidance. DCLG considers that the plans will have the following key components:

i. base information: short to medium-term cash flow projections, actuarial estimate of long-term funding needs, current funds and projected changes

ii. key assumptions

iii. risk management analysis

iv. employer contribution rates

v. certification of the plan by the administering authority and the fund actuary

vi. agreement to the plan by the authority's pensions committee after appropriate consultation.

7. DCLG acknowledges that the LGPS Administration Regulations would need to be amended before the financing plan could be introduced.

Local funding targets

8. DCLG proposes the local funding target as an alternative to the financing plan. The local funding target approach would involve essentially retaining the existing funding regime but would allow an administering authority to set a long-term funding target that is not 100 per cent. DCLG considers that long-term funding targets would be an essential feature of the funding strategy statement but that the new adjustment could ensure that any longer-term funding shortfall could be recovered within a prudentially set and publically accountable timeframe, thus stabilising pension costs.

9. DCLG is clear that adopting local funding targets would not mean that administering authorities are given unfettered powers to set funding levels and employer contribution rates. Instead, whilst administering authorities, actuaries and other stakeholders are to reach an agreed funding position in light of the valuation exercise, ultimately it would be for the administering authority to have the final say on issues of affordability, sustainability and fairness within the LGPS regulatory framework.

Revised employee contribution rates

10. DCLG considers that there are high earners in the LGPS who are paying a proportionately modest amount towards their pension benefits. DCLG proposes new contribution bands of 8.5 per cent for those earning between £75k and £110k and of 10 per cent for those earning more than £110k. There are consequential changes to lower bands, including a proposed extension of the lowest contribution band of 5.5 per cent to those earning up to £15k. DCLG hopes to introduce these changes from 1 April 2010.

Conclusion

11. The formal response to this consultation is attached at **Appendix A.**

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) NA
Human Rights Act Appraisal The recommendations contained in this report are compatible with the Human Rights Act 1998.
Environmental Appraisal Impossible to quantify.
Risk Management Appraisal Financial risks to the fund have been considered in formulating this response.
Community / Consultations Appraisal NA
Cabinet Member NA
Local Member NA
Appendices Appendix A – Response to DCLG consultation

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Date: 1 September 2009

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Dear Richard

Local Government Pension Scheme, Delivering Affordability, Viability and Fairness

This letter sets out a response from Shropshire Council acting as administering authority to the Shropshire County Pension Fund, to the consultation note issued on 25 June 2009. In preparing this response the Council has taken advice from the Fund actuary, Mercer Ltd. This response is submitted on behalf of the Shropshire County Pension Fund Pension Committee and has been agreed by the Committee at a meeting on 9th September 2009.

Our preliminary, high level, general comments on the proposals are provided in the following bullet points:

- Two possible new mechanisms are put forward in the consultation; local funding targets (LFT) and financing plans (FP). However, we note that there is no “in principle” reason why a choice should necessarily be made between adopting either one or the other – both approaches could potentially be applied as part of agreed funding mechanisms flowing from the 2010 actuarial valuation process. In other words, the two approaches put forward are not mutually exclusive.

- In fact the two approaches could in certain applications work together in tandem. If for example, say, a 90% funding target was adopted via the LFT mechanism then this would result in the actuarial valuation setting contribution rates only intended to deliver 90% of scheme benefit payments. As the actual benefits to members of the Scheme would continue to be paid in full as they fall due, irrespective of what LFT might be adopted, a financing plan approach could then be applied, using a cash-flow methodology, to determine how the remaining, unfunded, 10% of benefits would be provided for.

- However, we do not agree with applying a LFT of less than 100%, for practical and presentational reasons and we do not favour such an approach. The LFT approach should in our view be recognised as more broad than simply just the possibility of adopting a funding target not equal to 100%. There are many mechanisms already open to administering authorities (with their actuaries) to determine the funding target and objectives, via the Funding Strategy Statement process. In this context the LFT concept might be viewed as only a relatively minor tweaking of the mechanisms already available through the FSS process, including the consultation with employers which that process requires.

- If either or both of LFTs or FPs are to be implemented it is clear that further and additional guidance will be required by administering authorities to assist them. This will give a consistent framework across Funds in both interpreting new regulatory requirements and determining their plans and strategies.

- The financing plan approach is, in our view, potentially the more useful of the two options put forward. Nevertheless, we would not wish to close off the potential new flexibilities which the implementation of the LFT concept might allow.

- We would like further clarification please on how the financing plans envisaged would work in practise. Would the Financing Plans be developed and considered as part of the valuation or as part of a considered response to outcome of the valuation. Mercer's advice is that there are two possible approaches, either a or b set out below.

  a. An approach which the fund actuary may adopt, in consultation with the Fund, as part of determining and certifying the contributions payable by employers which are set out in the actuarial valuation report. This would imply that the year on year financial commitment of employers to the Fund continues to be determined solely via the actuarial contributions certificate, albeit now set in conjunction with a "Financing Plan".

  or

  b. Whether the Financing Plan is in some sense a response from the administering authority/employers to the actuary's valuation report and contributions certificate. In this case the implication would be that financing the scheme is only partly via contributions in accordance with the certificate, with the financing plan perhaps stating how benefits will be delivered (in the short, medium and long term) if contributions are not to be paid in full, for example due to affordability constraints. This might include a range of scenario projections with an exploration of how each possible out-turn would then be managed and financed. Clearly, in this case, the risk management analysis as envisaged in the consultation note would be particularly important.

- There is a concern that the new options, but perhaps particularly the FP approach, will make an already difficult and complex process even more complicated and lengthy, and this could be particularly so it seems if the intention of the FP concept were to follow the lines of b above.

In summary Shropshire Council, as administering authority to the Shropshire County Pension Fund, welcomes the proposals to give greater flexibility for determining contribution rates, but at the same time we are concerned that the new arrangements should not lead to any weakening of the overall funding principles for the LGPS. It is also important to ensure that funding plans are workable and transparent for employers, thereby enabling employers to have a clear understanding of the necessary funding costs of the Scheme, so that the balance between scheme benefits and costs can be set to meet the key objectives for the LGPS, namely "affordability, viability and fairness".

We support the proposition put forward to revise the Employee contribution tariff so as to increase the contribution rate for the higher paid employees. We disagree however with a reduction in contribution rate for the lower paid employees. Employees are already paying the existing contribution level and therefore we can see no merit in any reduction. Our preference would be that increases in the employee contribution rate be considered across all tariffs.

It is yet to be seen what effect the new LGPS cost-sharing regime has on employee contribution rates, so to consider reducing certain tariffs prior to its implementation seems counter productive. There is no evidence across the Shropshire Fund that it is the contribution rate that prompts employees to opt out of the scheme. The proportion of employees opting out of the scheme has actually dropped across the Shropshire Fund.

I hope you find the above comments useful.

Yours sincerely

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