Haringey Council

Agenda item:

Pensions Committee	On 17 September 2009

Report Title: **Consultation Draft: LGPS-Delivering Affordability, Viability and Fairness**

Report of **The Chief Financial Officer**

Signed :

Contact Officer : **Colin Duck-Corporate Finance**
Telephone 020 8489 3731

Wards(s) affected: All	Report for: Non key decision

1. Purpose of the report

1.1 To formulate a response to the Consultation Draft

2. Introduction by Cabinet Member

2.1 Not applicable.

3. State link(s) with Council Plan Priorities and actions and /or other Strategies:

3.1. Not applicable

4. Recommendation

4.1 That a response to the Consultation exercise initiated by the Communities and Local Government Department be formulated.

5. Reason for recommendation

5.1. To determine a basis for responding to the Consultation exercise .

6. Other options considered

6.1. None.

7. Summary

7.1. The Communities and Local Government Department is seeking responses to a consultation exercise which is considering changes to the current methodology concerning Pension Fund solvency and funding. Changes to employee tariff's are also considered.

8. Head of Legal Services Comments

8.1 The Head of Legal Services has been consulted on the content of this report. There are no specific legal comments on the report other than a general comment that the Committee must act in the interests of the fund and its stakeholders in considering the consultation response and take appropriate advice from its financial advisers.

9. Equalities & Community Cohesion Comments

9.1. There are no equalities issues arising from this report.

10. Consultation

10.1 Not applicable.

11. Service Financial Comments

11.1. It is important to ensure that any changes to the funding methodology of the LGPS retain the principle of full funding and recognise the need to provide an equitable balance between employers, stakeholders and taxpayers.

12. Use of appendices /Tables and photographs

14.2 Appendix 1 Letter dated 25 June 2009 from Communities and Local Government setting out details of a consultation exercise.

14.3 Appendix 2 Response to the Consultation provided by the Council's Consulting Actuary Hymans Robertson

13. Local Government (Access to Information) Act 1985

Letter dated 25 June 2009 from Communities and Local Government

14 Introduction

14.1 The Secretary of State for Communities and Local Government (C & LG) has initiated a consultation exercise (Appendix A) to consider some possible amendments which initially focus, for reasons of scheme stability and viability, on the 2010 valuation exercise. The following is a summary of the proposals.

15 Scope of Consultation

15.1 The propositions principally focus on the important regulatory and operational relationships between the actuarial valuation exercise and the requirement of each LGPS administering authority to produce and maintain a Funding Strategy Statement.

15.2 In addition, proposals are included for a re-alignment of the employee member pension tariff, with particular emphasis on the contribution of higher paid members towards their pension benefits.

16 Current Public Service Pension Policy Context

16.1 The Government's overall commitment to public service pension provision is that schemes must remain affordable and sustainable in the long term, and be consistent with the principle of fairness for all tax payers and between generations.

17 Actuarial valuations and Funding Strategy Statements

17.1 Ministers are of the view that unless some adjustments are made to stabilise the treatment of scheme liabilities at the 2010 valuation and so mitigate any short term adverse impacts of the current economic recession on the scheme, the effect on members, employers and tax payers could be disproportionately significant in terms of increased costs which could be reflected in council tax bills from 1 April 2011.

17.2 At present the actuarial exercise and its attendant regulatory structures involving Funding Strategy Statements and Statements of Investment Principles are in place to protect tax payers interests through the efficient long term management of liabilities within a prudent regulatory framework.

17.3 Despite this regulatory stability and its interaction with funding strategies there remains the likelihood of an adverse 2010 valuation outcome. Ministers are of the view that a closer regulatory re-alignment between the two could be useful to counter any risks that might otherwise adversely affect employers costs and tax payers and hence the on going stability of the scheme. The following are proposed to stabilise future scheme costs arising from the 2010 valuation exercise.

18 A possible new approach to solvency

18.1 Comments are invited on a proposition that new contribution rates will be set at future valuations at a level that will ensure that over time sufficient monies are available to meet all employer liabilities.

18.2 At present shortfalls, or deficits are identified by pension actuaries by reference to 100% funding in the long term.

18.3 Stakeholders have expressed the view that a 100% target can be artificial and imposes significant short term pressures on employers during periods of economic downturn due to falling investment returns. In addition, it fails to take in to account the effect on employers who have to meet cost increases upfront.

18.4 The actuarially defined target of 100% funding creates the concept of a deficit whenever the valuation outcome drops below this figure. Consequently commentators misinterpret this event as creating an immediate cost penalty to tax payers. The essence of the proposition in the paper is to better reflect local funding dynamics. The paper draws a distinction between liquidity (a measure of the ability to pay pensions as they become due) and solvency (the capacity of scheme employers to meet the pensions promise). At present this becomes a target of 100% funding. The draft questions whether fund authorities need to build up what is tantamount to a financial reserve in the process of achieving that solvency level.

18.5 The proposition of a more flexible model to reflect the constitutional permanence of local government is raised. This would involve the introduction of a new Financing Plan underpinned by a completely new funding strategy and secondly, the establishment of funding targets locally by fund authorities within much of the existing funding and valuation framework.

19 Financing Plans

19.1 The first approach would mean that instead of fund authorities coming forward with full (100%) funding plans to make good all past service deficits, it is suggested that integral to the preparation of their funding Strategy Statements, each LGPS administering authority would additionally prepare and maintain a Financing Plan. This would demonstrate how over the short, medium and long term, they will fund pension liabilities for their fund and for each employer bodies.

19.2 A Financing Plan could include the following key components:

Base information
- Short to medium cash flow projections
- Actuarial estimate of long term funding needs
- Current funds and projected changes

- Key assumptions
- Risk management analysis
- Employing body contribution rates to provide sufficient resources to meet liability projections for the fund overall and for each employing body
- Certification of the plan by the fund officer responsible for the administration of the funds affairs and the appointed actuary
- Agreement to the Financing Plan by the authority's formal pension committee, after proper consultation with all interested parties.

19.3 Whilst the proposed Financing Plan would have the effect of removing the current actuarially set long term solvency test involving a 'deficit' funding approach it would, at the same time, introduce a funding regime based on a much shorter time frame. As a consequence it may be regarded by some commentators as being inconsistent with current funding best practice. In any event any move away from long term 100% funding targets must retain the confidence of all stakeholders in being able to meet its statutory- based pension promise.

20 Local Funding Targets

20.1 An alternative approach could involve retaining the existing scheme funding regime but additionally would allow an LGPS administering authority to adopt a long term funding target which would not always be set out 100%. Justification for less than 100% funding, including its sustainability, would need to be made within the published Funding Strategy Statement.

20.2 Although long term funding targets would remain the new adjustment is intended to ensure that any longer term funding shortfall would be recovered within a prudentially set and publicly accountable timescale.

20.3 It is not intended to give administering authorities unfettered power to set funding levels and employer contribution rates. The intention is for the normal pre and post valuation dialogue between administering authorities, fund actuaries, and other stakeholders to continue with the view to reaching an agreed funding position in the light of the valuation exercise

20.4 It is intended that the proposed regulatory changes will put beyond doubt that ultimately it is for each administering authority, and most importantly its elected committee members to have the final say on questions of affordability and sustainability and fairness to local tax payers, within the framework set by the scheme's regulations framework.

21 Next Steps

21.1 Consultees are invited to comment on both how a proposed financing plan approach could apply, when read in conjunction with the existing Statements of Investment Principles and Funding Strategy Statements, and also how to ensure that fund authorities are able to adopt favourable, short term positions consistent with their long term pension liability. Alternatively, consultees are invited to comment on whether there is merit in the other approach involving locally selected funding targets, also within the framework established by existing Funding Strategy Statements and Statements of Investment Principles. Responses are required by 30 September 2009.

22 **Views of the Council's Consulting Actuary**

22.1 The Council's consulting actuary Hymans Robertson has provided a response to the consultation exercise and this is attached as Appendix B. Hymans views may be summarised as follows:

- They support the concept of financing plans, including, a requirement for a risk assessment to be carried out, if these demonstrably improve transparency and governance. It is Hymans' view that this could be achieved within the existing regulatory framework through revised guidance on the Funding Strategy Statements rather than through new regulations;
- Hymans do not support local funding targets and note that these already exist because of the different methods and assumptions being used to place a value on the assets and liabilities of the LGPS;
- Hymans do not support the proposals relating to a revised contribution tariff for employees because contribution rates were revised as recently as 1 April 2008. Consequently, a further change at this stage could cause a disproportionate administrative burden and member confusion and may make it more difficult to recruit and retain members earnings over £100,000;
- Assets and liabilities of LGPS funds should be assessed and disclosed on a consistent basis to enable all stakeholders to validly compare different funding approaches;
- The funding framework must have an increased focus on the interaction between contributions and investment strategy and require a meaningful degree of risk assessment and disclosure of risks relating to employers who are not directly funded by tax payers and finally,
- Whatever measures are put in place to secure a satisfactory outcome from the 2010 valuation from a local authority/tax payer perspective, it must be clear

that they do not obviate the need to review the benefit structure to secure the longer- term affordability and sustainability of the Scheme.

23 **Proposed basis of response to C & LG Consultation**

23.1 Having carefully considered the points raised in C & LG's letter, and the response of the Council's Consulting Actuary, Hymans Robertson, a proposed response for Members to consider is as follows:

23.2 Whatever methodology is adopted in order to define and underpin the notion of solvency i.e. 'Financing Plans' and/or 'Local Funding Targets' the detailed procedures supporting any change must be clear. In the case of 'Local Funding Targets', C & LG' s letter could be interpreted, due to its lack of clarity, as a partial abandonment of the concept of full funding. Should this concept be conceded for matters of short term expediency (e.g. concerns about an adverse 2010 valuation outcome) a potential funding burden could fall on future generations of taxpayers/stake holders which could manifest itself in increased contributions and/or reduced scheme benefits.

23.3 By contrast, 'Financing Plans' (which would in effect be deficit recovery plans) would give greater emphasis and support to the existing governance structure of Statements of Investment Principles and Funding Strategy Statements.

23.4 Turning to the proposed Employee Contribution Tariff it is considered that it would be inappropriate to make the suggested changes at this juncture for the following reasons;

- overall employee contributions to the Scheme are not forecast to change ;

- the current tariff was introduced on 1 April 2008. A further change so soon is likely to cause an unnecessary administrative burden due to the number and complexity of the tariff bands: and

- no evidence is provided to assess the impact of the proposals on the future pattern of recruitment and retention of staff.

24 **Recommendation**

23.4 Members views are sought on the Consultation exercise in order that a response is made on behalf of the administering authority by 30 September 2009.

APPENDIX 1

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LGPS Stakeholders in
England and Wales
(Addressees attached)

25 June 2009

Dear Colleague,

LOCAL GOVERNMENT PENSION SCHEME DELIVERING AFFORDABILITY, VIABILITY AND FAIRNESS

1. This informal consultation exercise 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. A later, separate exercise, will consider new ways in which the LGPS could possibly be reformed to provide more workforce - focused provision pension for the 21st century.

2. Ministers wish to see the full engagement of all stakeholders in this particular exercise to secure a consensus quickly on a number of practical and reasonable amendments to the Scheme's regulatory framework to beneficially impact on the conduct and outcomes of the 2010 valuation and to assist in maintaining Scheme viability generally. A parallel, separate consultation exercise on the broader debate, announced when John Healey spoke at the NAPF Local Authority Conference on 19 May, about the longer term future of the Scheme, and how it might best respond to changes in the workplace, workforce and economy will issue shortly.

Background

3. The LGPS, as provided in England and Wales, is a statutory, public service, funded, occupational pension scheme which provides guaranteed pension benefits to local authority employees, and to employees of related and admitted employers.

4. The Scheme's local administering authorities pay benefits and manage its pension funds within the terms set out in secondary legislation made under the Superannuation Act 1972. A prudential regulatory framework provides Scheme pension fund administering authorities with all the necessary powers to manage and invest their pension funds. Investment income generated, as well as the operating and other costs incurred, is the responsibility of the appropriate LGPS administering authority; any surplus is available to reduce employers' liabilities and to re-invest within the authority's investment strategy.

5. At the 31 March 2007 triennial actuarial valuation, funds' total assets were valued at £132 billion with liabilities totalling £159 billion giving a shortfall between assets and liabilities of £27 billion, or a scheme-wide funding level of 83% (up from 74% in 2004).

6. The LGPS provides inflation-linked pension benefits based on a member's final salary at retirement and has some 3.7 million members. Stewardship, policy and regulatory responsibilities for the Scheme in England and Wales rest with the Secretary of State for Communities and Local Government.

7 A major Scheme reform saw the introduction from 1 April 2008 of a new-look LGPS including revised benefit terms. The Scheme's accrual rate was improved from 1/80ths to 1/60ths with the normal retirement age of 65 years being retained and new ill health provisions and other benefit adjustments within a fixed, agreed cost-envelope. Employees currently contribute between 5.5% and 7.5% of their pay on a set tariff which yields about 6.4% of total payroll. Employers' contributions, fixed until 31 March 2011, are adjusted following the triennial valuation of individual LGPS pension funds. Each individual pension fund authority is required to set an employers' level of contribution to ensure its fund is solvent and able to meet its existing and future liabilities.

Scope of consultation

8. This discussion document sets out initial suggestions for stakeholders to consider as a feasible and balanced response to the current stock market impacts on LGPS pension fund liabilities likely to be identified in the forthcoming 2010 valuation exercise. The propositions principally focus on the important regulatory and operational relationship between the actuarial valuation exercise and the requirement on each LGPS administering authority to produce and maintain a Funding Strategy Statement. It would be appropriate also to support the proposals with new advice to stakeholders on the issue of Scheme funding, cost stability and security.

9. In addition, and alongside the introduction of the new LGPS cost-sharing regime, this may be an opportune time also to consider a re-alignment of the employee member pension contribution tariff, and particularly the proportion of pensionable pay being contributed by higher paid members Towards their pension benefits.

10. Ministers wish to see an authoritative, evidence-based debate on a range of elements which fall within the Scheme's current framework. It is proposed to issue a paper shortly which sets out several policy themes for analysis and discussion by Scheme stakeholders about the possible future direction of the LGPS in the medium/ longer terms.

11. Both strands need, to be seen within the broad context of all public service pension schemes. Communities and Local Government remains in close touch with other relevant sponsoring Government Departments, as well as Scheme-specific stakeholders.

Current public service pension policy context

12. The Government's overall commitment to public service pension provision generally and for the Local Government Pension Scheme in England and Wales in particular, is that such schemes remain affordable and sustainable in the long term, be consistent with the principle of fairness for all taxpayers and between generations.

13. Ministers are on record regarding their intentions to ensure that the LGPS can continue to meet the needs of its stakeholders. Their policy for the Scheme is one based on affordable retention within the broad national policy parameters expressed above. At the same time, the guarantees that underpin such arrangements, supported by taxpayers, require the terms of the Scheme to be kept under review, to reflect best practice and continue to be fair and cost-effective in terms of the level of provision and the cost of delivery.

14. The provision of a good quality occupational pension provision is a key part of the total remuneration package of public servants. The Local Government Association see the LGPS as an essential component of the total reward package currently available to recruit, retain and to motivate local authority employees. The local authority trade unions take much the same view.

15. However, in providing any level of public sector benefit provision, it is acknowledged by stakeholders that it remains essential to ensure an equitable balance at all times between the full cost of providing LGPS benefits within that statutory, guaranteed framework, and the standard of the actual pension benefits provided by the Scheme for its membership.

16. In assessing the prospect of any possible regulatory changes to the LGPS in England and Wales, the Government wishes to continue to maintain a viable and affordable Scheme, one that caters for its current and future workforces' needs and which remains fair both to providers and beneficiaries, as well as to taxpayers who ultimately guarantee its pension promise.

Actuarial valuations and Funding Strategy Statements

17. The next LGPS actuarial valuation exercise in England and Wales, required by regulation 36 of the 2008 Administration regulations, takes place as at 31 March 2010. This event, along with the influences of each administering authority's Funding Strategy Statement and Statements of Investment Principles, will determine new rates of Scheme employer contributions from 1 April 2011 until 31 March 2014. The subsequent valuation takes place on 31 March 2013.

18. Many stakeholders believe that unless some adjustments are made to stabilise the treatment of scheme liabilities at the 2010 valuation, and so mitigate any short term adverse impacts of the current economic recession on the Scheme, the effect on members, employers and taxpayers could be disproportionately significant in terms of increased costs and so potentially council tax bills from 1 April 2011, notwithstanding the application of the new LGPS cost share / capping provisions.

19. The actuarial valuation exercise and its attendant regulatory structures involving Funding Strategy Statements and Statements of Investment Principles, are in place to protect taxpayers' interests through the efficient long term management of liabilities within a prudent regulatory framework. Regulation 36 (6)(b) of the LGPS Administration Regulations 2008 requires that contribution increases for employers in general, following each valuation exercise, should be set at as constant a rate as possible, and each LGPS administering authority engages with its actuary to determine how best to focus on the longer term funding plan each LGPS fund authority needs to achieve that position.

20. The 2010 valuation exercise will provide regulatory stability and discipline, and its interaction with funding strategies which continue to statutorily protect taxpayers, and guarantee the pension promise for Scheme members. Nevertheless, there remains the likelihood of an adverse 2010 outcome. Ministers believe that a closer regulatory realignment, therefore, between the two could be useful to counter any risks that might otherwise adversely affect employers costs and taxpayers and the on-going stability of the Scheme.

21. The following paragraphs explore steps to stabilise future Scheme costs arising from the 2010 valuation exercise. The propositions draw on the outcome of views expressed by key national stakeholders in recent discussions. Liaison will continue with the interested parties over the coming months, particularly on the details of actual proposals and any necessary guidance, including the involvement of the LGPS Policy Review Group.

A possible new approach to solvency

22. Consultees are invited to comment on a proposition involving an amendment to the Scheme regulations, which already include a specific (but undefined) solvency requirement (Regulation 36(5) of the 2008 Administration Regulations), and modify it with a provision which requires each fund's actuary, first to take full account of the affordability of employers' liabilities to pay pensions and to meet liabilities when undertaking three-yearly fund actuarial valuations and, second, to ensure consistency with an administering authority's funding objectives as set out in its Funding Strategy Statement.

23. In practice, this will result in new employer contribution rates being set at each valuation at such a level as to ensure that, over time, sufficient monies are available as required to meet all employers' liabilities.

24. Although a shortfall or deficit may be identified by individual fund valuations, it appears to be the case across the Scheme that contribution rates are set by pension actuaries, for each triennial valuation period, to ensure that the fund will be able to meet its pensions promise by achieving 100% funding in the long term, to meet the funding strategy set by the administering authority.

25. Stakeholders have mentioned in recent discussions that a uniform 100% funding target can become artificial and impose significant short term cost pressures on employers during times of economic downturn and falling investment returns. It fails also to take into account the effect on employers' who have to meet cost increases up front, and over the short term, when in every case this is far from justified.

26. For the LGPS, the effect has implications for council tax payers, particularly in the current economic recession. Measuring the Scheme, therefore, against an actuarially-defined notional 100% funding target automatically creates the concept of a deficit-event whenever the funding ratio falls below 100%. This is frequently misinterpreted by commentators as creating an immediate, and global cost penalty for council tax payers. The essence of the proposition in this paper, therefore, is to consider better reflecting in the regulations the actual local funding dynamics of the Scheme and to remove the opportunity for any negative interpretations which can fail to understand the Scheme's inherent funding disciplines and its protections for taxpayers and members, along side its regulatory permanence.

27. Although liquidity is a measure of the ability to pay pensions as they become due, solvency is concerned with the capacity and status of scheme employers to meet the pensions promise. That means having sufficient assets to meet all future pension liabilities. At present, this test often becomes a target of 100% funding but, given the strong liquidity of the Scheme, the constitutional permanence of local government and a strong employers' covenant, it is questionable whether fund authorities need to build up what, in effect, amounts to a financial reserve in the process of achieving that solvency level.

28. Clearly, a financial reserve and investment assets, are needed to meet short-term liquidity requirements but, equally, setting employer contribution rates at a level to achieve long term funding targets can be considered to be a blunt instrument which imposes unrealistic and burdensome short/medium term costs on scheme employers, and, potentially, council taxpayers.

29. Looking ahead, therefore, a more flexible model might be appropriate, to better reflect the individual circumstances of each pension fund authority and which takes full account of the long term constitutional permanence of local government, its employer covenant and its statutory basis. In informal discussions with stakeholders, two separate sets of proposals have emerged. First, involving the introduction of a new Financing Plan underpinned by a completely new funding strategy and secondly, the establishment of funding targets set locally by fund authorities within much of the existing funding and valuation framework.

Financing Plans

30. The first approach would mean that, instead of fund authorities coming forward with full (100%) funding recovery plans to make good all past service deficits, it is suggested that, integral to the preparation of their Funding Strategy Statements, each LGPS administering authority could additionally prepare and maintain a Financing Plan to demonstrate how over the short, medium and then long term, they will fund pension liabilities for their fund and for each of its employer bodies. The Financing Plan would detail and determine local future income streams and how it is proposed to manage the funding of long term liabilities, demonstrating that it has taken a prudent approach, based always on reasonable, realisable assumptions and qualified professional advice. It would also take into account local budgetary constraints and recognise the reality of local resource and other parameters within which each fund must operate.

31. A Financing Plan could include the following key components and these could, in due course, be reflected in the regulations, or in authoritative guidance: -

- base information :-
    - short to medium cash flow projections
    - actuarial estimate of long term funding needs
    - current funds and projected changes
- key assumptions
- risk management analysis
- employing body contribution rates to provide sufficient resources to meet the liability projections for the fund overall and each employing body
- certification of the plan by the fund officer responsible for the administration of the fund's affairs and the appointed actuary

- agreement to the Financing Plan by the authority's formal pension committee, after proper consultation with all interested parties.

32. This approach would require formal amendments to the Scheme's regulations to require the preparation and inclusion of new Financing Plans, within an amended Funding Strategy Statement, no later than 1 October 2010 or another date following the 2010 valuation, and no later than six months after the valuation date specified. This is intended to ensure that strategic decisions taken by individual local administering authorities on funding and contribution levels are prudent and viable, locally transparent and capable of delivering secure, guaranteed payments alongside regular monitoring. It would provide a clear regulatory-based timetable over which individual LGPS funds can meet their own, locally adopted, prudently funded and financed payment plans.

33. However, the Department is mindful that the proposed Financing Plan, whilst having the effect of removing the current actuarially-set long term solvency test involving a "deficit funding" approach, would, at the same time, introduce a funding regime based on a much shorter time frame which may be regarded by some commentators as being inconsistent with current funding best practice. Although the policy aim would be to stabilise pension costs going forward at the same time as moving away from rigid, long term 100% funding targets, it is equally important that the Scheme retains the confidence of all stakeholders in being able to meet its statutory-based pension promise. No changes are envisaged to the Scheme regulations which currently require specific provisions to set employers` contributions to retain a constancy which eliminates any possibility of contributions being reduced and continues to ensure stability.

Local Funding Targets

34. An alternative approach could involve essentially retaining the existing Scheme funding regime but additionally would allow an LGPS administering authority to adopt a long-term funding target which would not necessarily always be set at 100%, provided this could be sustained and transparently justified by the pension fund administering authority within its published Funding Strategy Statement.

35. Long term funding targets would, therefore, continue to be an essential feature of the Funding Strategy Statement, as indeed would deficit recovery plans over a locally chosen period. This new adjustment could ensure that any longer-term funding shortfall could be recovered within a prudentially-set, and publically accountable timescale. It stabilises pension costs going forward, without losing sight of the fact that the Scheme must meet its statutory pension promise.

36. This does not mean that LGPS administering authorities are to be given unfettered powers to set funding levels and employer contribution rates. That would be to deny the prudentially critical role of the valuation and subsequent actions by the administering authority. The intention rather is for the normal pre-and post-valuation dialogue between administering authorities, fund actuaries, and other stakeholders to continue with the view to reaching an agreed funding position in the light of the valuation exercise outcome. However, the proposed regulatory changes would put beyond doubt that ultimately it is for each locally administering authority, and most importantly its elected committee members, to have the final say on questions of affordability and sustainability and fairness to local taxpayers, within the framework set by the Scheme's regulatory framework.

Next steps

37. Discussions with stakeholders are being arranged to consider the merits of these possible new arrangements which could then be carried forward into draft amending regulations to be issued later in the year as a statutory consultation. Detailed guidance could be prepared with the assistance of CIPFA, to help LGPS authorities prepare for any regulatory changes.

38. Consultees are therefore invited to comment on both how a proposed financing plan approach could apply, when read in conjunction with the existing Statements of Investment Principles and Funding Strategy Statements, and also how to ensure that fund authorities are able to adopt favourable short term positions consistent with their long term pension liabilities. Alternatively, consultees are invited to comment on whether there is merit in the other approach involving locally selected funding targets, also within the framework established by existing Funding Strategy Statements and Statements of Investment Principles.

A Revised Employee Contribution Tariff

39. A proposition is also being considered to amend the existing LGPS tariff which set the level of employee contributions linked to their pensionable pay, with new, higher tariffs for members who annually earn in excess, say, of £75,000, together with an extension of the lower rate of contributions for the lower paid.

40. The new LGPS Scheme introduced on 1st April 2008 included a new banded contribution arrangement with a top level of 7.5% of pensionable pay for those whose earnings are in excess £75,000. However, it is now believed that there are many high earners in the local government workforce who are paying a proportionately modest amount towards their pension benefits.

At the same time, given the very high proportion of part-time employees in the Scheme, it is seems equitable to re-consider the extent, in tariff terms, of the lower rate of 5.5% of pensionable pay. This latter step should directly help to recruit and retain membership of lower paid employees into the Scheme who, according to recent UNISON research, find the costs of membership prohibitive.

41. An example of the scope of a possible future regulatory amendment is illustrated below. Under this example, members earning over £110,000 per year could pay a contribution rate of 10% of pay, and those below in the next band (earning over £75,000) a rate of 8.5%. Meanwhile, many members earning less than £22,001 p.a. would benefit from a lower rate. The table is illustrative at this stage and does not represent any firm commitment by Ministers.

42. Those earning between £30,001 to £75,000 per year would also have to contribute more: +0.2% or +0.3%, to avoid "cliff edge" increases in contributions within the tariff.

43. Subject to the outcome of any statutory consultation the new contribution tariff could take effect from 1 April 2010.

Table 1 – Possible New Contribution Tariff

Band	Pay Range (pay per year)	New Contribution Rate	Difference from current LGPS rate
1	£0 - £15,000	5.5%	No change for members earning up to £12,000 per year -0.3% for members earning from £12,001 to £14,000
2a	£15,001 to £18,000	6.0%	+ 0.1% This apparent anomaly is justified by the significant reduction in rate for Band 3 below
2b	**£18,001 to £22,000**	6.0%	**-0.5%**
3	£22,001 to £30,000	6.5%	No change
4	£30,001 to £40,000	7.0%	+0.2%
5	£40,001 to £75,000	7.5%	+0.3%
6	**£75,001 to £100,000**	8.5%	**+1.0%**
7	**£110,001+**	10.0%	**+2.5%**
Yield = 6.42% of payroll			

Responses

44. Consultees are invited to respond to this informal consultation exercise no later, please, than 30 September and preferably by the middle of September, if this is at all possible. The LGPS Policy Review Group will be considering the paper in the course of its deliberations.

45. Responses should be sent to Richard McDonagh at the above address, Zone 5/F6, or e-mail to richard.mcdonagh@communities.gsi.gov.uk. Telephone for enquiries is 020 7944 4730.

46. If any consultees would like to meet to discuss the propositions in detail and any other matter which stems from this exercise, could they please contact Diana Abelson at diana.abelson@communities.gsi.gov.uk or by telephone on 020 7944 5971, to make the necessary arrangements.

Yours sincerely

Terry Crossley.

TBJ Crossley

ADDRESSEES

The Chief Executive of:
- County Councils (England)
- Metropolitan Borough Councils (England)
- Unitary Councils (England)
- County and County Borough Councils in Wales
- London Borough Councils
- South Yorkshire Pensions Authority
- Tameside Metropolitan Borough Council
- Wirral Metropolitan Borough Council
- City of Bradford Metropolitan District Council
- South Tyneside Metropolitan Borough Council
- Wolverhampton City Council
- London Pension Fund Authority
- Environment Agency
- Police Authorities in England and Wales

Town Clerk, City of London Corporation
Clerk, South Yorkshire PTA
Clerk, West Midlands PTA

The Secretaries of:
- Local Government Association
- LGPC
- Employers' Organisation for Local Government (LGE)
- PPMA
- CIPFA

- Society of County Treasurers
- Society of District Council Treasurers
- Society of Welsh Treasurers
- Society of Metropolitan Treasurers
- Society of London Treasurers
- Association of Consulting Actuaries
- Association of London Councils

Trades Union Congress
UNISON
GMB/
UCATT
Aspect
Unite
NAPO

CIPFA
Audit Commission

APPENDIX 2

HYMANS ROBERTSON

Local Government Pension Scheme, Delivering Affordability, Viability and Fairness

Hymans Robertson's response to CLG's consultation on funding

This is Hymans Robertson LLP's response to the consultation paper issued by CLG on 25 June 2009.

Securing the long-term sustainability and affordability of the LGPS is vital. Neither the new LGPS in England and Wales, introduced from 1 April 2008, nor the proposed cost sharing measures to be effective from 1 April 2010, are sufficient to achieve this. We therefore welcome CLG's review of the LGPS in England and Wales. This document sets out our views on the first stage in the review, which relates to the near term, in particular the forthcoming triennial valuation of the Scheme.

We know how concerned our LGPS fund clients are about the outcome from the 2010 valuations and that current budgetary constraints mean that council tax must rise or services be cut (neither of which is politically acceptable) if there are further substantial increases in pension contributions. Over the last 18 months, we have been working with clients to determine how to approach funding strategy in today's challenging economic environment. We are confident that local authority pension contributions can be maintained at affordable levels following the 2010 valuations, within the current regulatory framework. **Our immediate reaction is therefore that no regulatory changes are required to ensure stability of local authority contributions following the 2010 valuations.** However, as the leading provider of actuarial services to the LGPS, we believe that we have a responsibility to help ensure all LGPS funds make informed decisions that best suit their circumstances. We have therefore deliberately taken a positive approach to the consultation where it supports administering authorities in making informed decisions. We also firmly believe that checks and balances need to apply to the setting of the contribution strategy. Our response to the funding consultation should be considered in that context.

The Broader Context: Funding Principles

Before commenting on CLG's consultation, it is worth setting out what we believe should underlie the regulatory framework for the funding of the LGPS:

1. Maintain a Funded Approach

The LGPS must retain the ambition of full funding. The public sector unfunded model is arguably broken with some of the schemes requiring a regular top-up from Treasury to balance the books. This situation has arisen because of demographic changes and a failure to recognise increasing pension costs in employer contributions. It has now caught the imagination of many commentators and we believe that it would be very damaging to the reputation of the LGPS if it were allowed to become wholly or partly unfunded. This would transfer an even greater burden onto future government finances (and taxpayers) at a time when benefit payments across the LGPS in England are already rising faster than contributions[1] due to the changing profile of the membership, leading to further inequity between generations of taxpayers.

[1] Based on CLG's own statistics, in percentage terms - benefit expenditure rose by 10% from £4.8bn in 2006/07 to £5.2bn in 2007/08 compared to an 8% rise in contributions from £6.2bn in 2006/07 to £6.7bn in 2007/08

If employer contribution rates are held reasonably stable and local government employment does not grow significantly, it is conceivable that benefit expenditure will exceed contribution income within 10 years. This significantly weakens the "liquidity" argument for making the scheme unfunded or partially funded. It supports our view that the funded status of the scheme with a 100% solvency target must be maintained.

2. Maintain a Long-Term Focus

We believe that it is possible to manage the outcome of the 2010 valuations to the satisfaction of local authorities and CLG, i.e. by setting employer contributions for local authorities which are not materially changed from current levels. However, in order to do so, the funding framework must be based on long-term principles. It is not desirable to adopt a short term approach to the setting of contribution rates (i.e. increasing the rates substantially) because of near term financial conditions. This is particularly true if we consider the immediate impact that would have on front line services. Conversely, it is not possible to continually adopt short-term measures at successive valuations as a means of obscuring the longer term issue: the increasing cost of the benefits due to longer life expectancy and lower real interest rates.

Irrespective of the outcome of this consultation on the forthcoming valuation, CLG must address the cost of the scheme and take forward the benefit design phase of the consultation to secure the long-term sustainability of the scheme.

3. Require Consistent Measurement

A valid comparison of funding levels and contribution rates across funds can only achieved by comparing results on a consistent basis of measurement. LGPS funds cannot currently measure themselves against their peers, because of the inconsistency of the actuarial bases and pace of funding. A conservatively managed scheme with a faster pace of funding may be in much better financial health than a scheme using less prudent assumptions; but simple peer group comparison using inconsistent bases may show the opposite. We understand that GAD produces a review of funding bases for CLG; however, this is not currently published and hence does not help funds understand their relative position. We are not advocating a common funding basis; the level of contributions and pace of funding will still be set locally. However, the requirement to report on a prescribed benchmark basis would enable administering authorities, employers and other stakeholders to assess the relative reliance of individual schemes' contribution strategies on aspects such as future investment returns

In the interests of transparency and to assist in risk assessment, the funding framework should require disclosure of assets and liabilities on a consistent prescribed basis across the LGPS[2], as well as on each fund's individual funding basis.

4. Require a Robust Risk Assessment

Scheme benefits are funded through a combination of contributions and investment returns. Traditional actuarial techniques place a single value on pension scheme liabilities and compare this to the value of assets to measure a scheme's solvency. The weakness of this approach is that it does not measure how likely it is that the fund will have sufficient assets to meet its future benefit promises.

[2] It is not essential, or even desirable, for the bases to be identical, as long as the key assumptions, i.e. the financial assumptions and post-retirement longevity assumptions are the same.

The approach which we are proposing to use for the 2010 valuations (and beyond) begins with applying the traditional approach to deliver objective measurement of the financial health of the fund. Crucially, however, it then combines this with a stochastic risk assessment which considers how the financial position of the fund may develop under a range of different possible outcomes; and gives an indication of how likely it is that the fund will return to full funding over various time periods. We believe that this type of risk-based approach will become best practice in the private sector and should be embraced by the LGPS. This also adds to the confidence that administering authorities can have when considering the risks inherent in their contribution strategy and pace of funding.

Greater analysis of funding and investment risks should be required as an integral part of the development of funding strategy. This will ensure funds fully understand the potential implications of their decisions and should ensure better decision-making.

5. Recognise the Multi-Employer Nature of the Scheme

Whilst local authority employers may account for the majority of LGPS assets and liabilities there are many other employers which participate in the scheme, whose characteristics are very different from local authorities in terms of their time horizon and security of covenant. CLG's consultation is devoid of detail (perhaps deliberately) on how admission bodies and other shorter-term or less secure employers should be dealt with.

Any change in the funding framework in which LGPS funds operate must permit, perhaps even require, an approach which is sufficiently flexible to cater for the different circumstances of different employers. Further, bodies which are funded by tax-payers must be required to quantify the level of their exposure to funding risks in relation to the pension benefits of other employers.

6. Distinguish Cost and Contributions

In our view a valid criticism of public sector pensions policy is that all too often policymakers misinterpret the relatively low employer contribution rates payable in public sector schemes (relative to rates payable in private sector schemes providing comparable benefits) as reflecting a lower cost of benefits. The lower rates are not a reflection of benefit cost; they largely reflect the fact that private sector schemes are addressing the cost of benefits at a faster pace than in the public sector. Administering authorities and CLG must appreciate the distinction between the contributions payable by employers and the cost of the benefits: paying a lower contribution rate, (at least for now) does not make the benefits cheaper to provide!

This distinction could be better reflected by requiring funds to consider explicitly how variable pension costs might be and how the contribution strategy deals with that variability as part of the valuation process. For example, the analysis could consider the effect of investment returns or life expectancy which were higher or lower than the valuation assumptions.

Specific Comments on the Consultation

Liquidity v solvency

Whilst the positive cashflows which generally characterise LGPS funds have proved beneficial in the current economic climate since funds have not been forced sellers of assets whose prices have plummeted, we are concerned at the consultation paper's suggestion that this liquidity is a justifiable reason for softening funding targets. In particular, the use of language such as it being "questionable whether fund authorities need to build up.... a financial reserve" worries us, appearing as it does, to question the very structure of the LGPS as a funded arrangement. The principle of a funded arrangement is to pay for benefits as they accrue, in contrast to unfunded arrangements where benefits are paid from revenue and there inevitably comes a point where the scheme becomes unsustainable without significant additional funding/contributions. Whilst the unfunded public sector schemes may appear to be more affordable this is merely a function of the opaque way in which their costs are accounted for and it would be a travesty if the LGPS were to abandon the funded model that has hitherto served it so well.

Financing Plans

Trustees in the private sector are currently required to produce a statement of funding principles and, if the scheme is in deficit, a separate recovery plan detailing how the trustees and sponsor plan to achieve full funding and the period over which they aim for this to be achieved. It is not clear from the consultation paper whether the suggested financing plans would perform the same function as the recovery plan in the private sector, but, on the face of it, the proposals seem sensible. In particular, we support the suggestion that a financing plan could include projections of benefit cashflows and asset information and would suggest that these cashflow projections include information on the chance of particular outcomes occurring, rather than simply illustrating a number of potential scenarios with no information on how likely those scenarios are. We are also very supportive of any proposals to incorporate risk management analysis within the financing plan, although this could be achieved through the existing funding strategy statement, with updated guidance on the content of these statements..

One potential drawback of the proposed financing plan is the potentially limited extent to which it could allow for the specific circumstances of individual employers. To rectify this, we would suggest that asset and liability projections be included within the financing plan for the following groups of employers, in addition to reporting at a whole fund level as suggested in the consultation document:

- local authorities and government sponsored bodies (this could be extended to include all scheduled bodies);
- transferee admission bodies and community admission bodies with a guarantor;
- admission bodies with no guarantor or other security; and
- former employers (i.e. assets and liabilities which are effectively "orphaned" within the fund),

where the projections would be over a period or periods which are reflective of the likely future period of participation of the group of employers.

In order to ensure that financing plans are good quality, helpful documents and that there is consistency between funds, we would propose that any regulatory requirements are supplemented by guidance, such as that produced by CIPFA on the funding strategy statements.

In addition to disclosing the valuation results on the funding basis, we would also propose that funds be required to disclose the funding level on a consistent basis to enable the level of prudence adopted by different funds to be readily compared. This funding level need not be used to determine the fund's solvency measure or employer contribution rates but would instead act as a limit on the extent to which funds subjugate prudence and solvency in favour of affordability and stability.

Any requirements to draw up a financing plan must improve transparency of funding and the valuation process, demonstrably contributing to good governance in the LGPS. They must not simply be used as a short-term fix to permit infinitely long deficit recovery periods and hence ensure an acceptable outcome for the 2010 valuations.

Local Funding Targets

Representatives from CLG have made it very clear that the suggestion of local funding targets is not in any way a return to the 75% funding regime which was introduced alongside the community charge in the 1980s. It is unfortunate, however, that on reading the consultation document, this subtlety passed many people by, including us. Irrespective of CLG's clarification, it seems to us that such an approach will inevitably lead to accusations of softening funding bases and to the LGPS being subject to many of the same criticisms of a lack of objective assessment of cost that are currently made of the unfunded schemes. For this reason alone we would reject the concept of a local funding target that does not necessarily aim to have sufficient assets to meet promised benefit payments.

We would also note that local funding targets already exist since there are a variety of different methods and assumptions being used to place a value on the assets and liabilities of LGPS funds, leading to very different solvency targets. We are concerned that these differences are not understood by the funds themselves. Further, we believe that it would be very helpful for all funds to publish their funding level on a consistent basis to help measure the degree of prudence within the bases adopted. We are aware that CLG currently commissions the Government Actuary's Department to undertake an audit of valuation bases, and it would be helpful if this were published. Although there are valuation surveys undertaken by interested parties, such as the Society of County Treasurers, these are skewed by the different bases adopted and do not cover all LGPS funds. We therefore believe that it would be beneficial to the funds themselves, if they were able benchmark their own position against their peers on a like-for-like basis. Although not within CLG's remit, we believe that it would also be helpful for the other public sector schemes to report their liabilities on the same basis. We would also note that, in the private sector, the Pensions Regulator assesses the valuation bases adopted by trustees and investigates any which it considers to be inadequate.

Given the public and media interest in public sector pensions and the need to demonstrate good governance and transparency of funding, a comparison of funding approaches, assessed using a consistent basis, should be published. Further, CLG should consider whether its role should more closely mirror that of the Regulator in the private sector. There is also a strong argument for extending this to other public sector schemes.

Employee contribution rates

The consultation paper suggests an amendment to the employee contribution rate tariffs introduced from 1 April 2008 to increase the percentage of pay rates for those earning above £30,000 per annum and to reduce the rates for the lower paid. We understand that the rationale for this is to make the scheme fairer for the lower paid, many of whom currently opt out of the scheme. Total employee contributions to the scheme are not intended to change.

We are not supportive of the proposed amendments for the following reasons:

- further changes so soon after the recent changes are likely to cause disproportionate administrative headaches and member confusion;
- there is no evidence that a 0.3% p.a. reduction in the employee contribution rate for those earning between £12,001 and £15,000 would have any effect in terms of encouraging those who have opted out of the scheme to join it;
- given the existence of means-tested state pension benefits it is debatable whether CLG should be trying to encourage lower paid members into the scheme, further analysis is required; and
- the biggest differential in earnings between the public and private sector is amongst those on the highest grades. Further increases in employee contribution rate of 1% for those earning over £75,000 and 2.5% for those earning over £100,000 will either make it more difficult to recruit and retain officers at the highest level or will lead to increased pressure on pay levels which, if it leads to higher pay, would increase past service liabilities and hence extra pension costs for employers.

We would also note that the final salary structure of the scheme favours those with high pay increases rather than the higher paid per se.

In our view, improving fairness of the scheme should be tackled in a further stage of CLG's review of the LGPS via the benefit structure rather than through the employee contribution scale.

In conclusion

We support the concept of financing plans, including, a requirement for a risk assessment to be carried out, if these demonstrably improve transparency and governance. However, we note that this could be achieved within the existing regulatory framework through revised guidance on the funding strategy statements rather than through new regulations.

We do not support local funding targets and note that these already exist (although this may not be well understood).

We are not supportive of the proposals relating to a revised contribution tariff for employees.

Assets and liabilities of LGPS funds should be assessed and disclosed on a consistent basis to enable all stakeholders to validly compare different funding approaches.

The funding framework must have an increased focus on the interaction between contributions and investment strategy and require a meaningful degree of risk assessment and disclosure.

The funding framework should increase the disclosure of risks relating to employers who are not directly funded by taxpayers.

Whatever measures are put in place to secure a satisfactory outcome from the 2010 valuations from a local authority / taxpayer perspective, it must be clear that they do not obviate the need to review the benefit structure to secure the longer-term affordability and sustainability of the scheme.