ITEM NO: 13

Report To:	**Pension Fund Management Panel**
Date:	18 September 2009
Reporting Officer:	Peter Morris, Director of Pensions
Subject :	**LGPS – DELIVERING AFFORDABILITY, VIABILITY AND FAIRNESS; CLG INFORMAL CONSULTATION**
Report Summary:	The report comments on the latest CLG consultation about the Scheme.
Recommendation:	(i) The Panel's views are sought on the issues raised in the consultation (ii) The Director of Pensions responds to CLG reflecting the Panel's views.
Financial Implications: (Authorised by the Borough Treasurer)	Funding at anything less than 100% in the long-term will transfer some costs to the tax-payers of the future. The proposed changes to employee contribution rates are expected to be broadly neutral in the short-term.
Legal Implications: (Authorised by the Solicitor to the Fund)	The consultation is an informal one. Nevertheless, given the size of the pension fund and it status as a lead in good practise it is important that the pension fund responds to any consultation. Any eventual amendments to the Scheme will be applied.
Risk Management:	Maintaining affordability of the Scheme is critical to its long term viability. In determining contribution rates, consideration needs to be given to stability of cost, affordability, prudence and stewardship. The consultation paper is primarily focusing on the stability matters.
ACCESS TO INFORMATION:	**NON-CONFIDENTIAL** **This report does not contain information which warrants its consideration in the absence of the Press or members of the public.**
Background Papers:	**Appendix 1** - Letter from Communities and Local Government (CLG) dated 25.06.09. **Appendix 2** – Consultation response of Hymans Robertson (Fund Actuary) For further information please contact Ged Dale, Head of Pensions Administration, Pensions Office, Concord Suite, Manchester Road, Droylsden. Tel 0161 301 7227, email ged.dale@gmpf.org.uk

1. INTRODUCTION

1.1 On 25 June 2009 the CLG published an informal consultation regarding the LGPS – Delivering Affordability, Viability and Fairness. A copy of this letter is attached as **Appendix 1**. The purpose of this report is to summarise CLG's proposals, comment thereon and seek the Panel's views so that a response can be submitted to CLG. The closing date for responses is the end of September 2009. The LGPS Policy Review Group will be considering the matters raised in the paper as part of its deliberations.

2. CLG INFORMAL CONSULTATION

2.1 "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."

2.2 This consultation is the first of two consultations and it relates in the main to the 2010 actuarial valuations. It foresees that the results of these will typically show substantial deficits. The CLG therefore wish 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". The Scheme's regulations and the Fund's own "Funding Strategy Statement" recognise stability of cost as an important objective alongside prudence, affordability and stewardship. CLG in this paper are looking at further measures to help deliver stability and manage contribution rate increases.

2.3 The letter notes that solvency traditionally requires liabilities being matched by assets, with a target of 100% funding. However the CLG questions whether full funding is always required, taking into account "the constitutional permanence of local government".

2.4 One suggested approach to providing a more flexible model would be using a Financing Plan. This would complement (or be part of) the existing Funding Strategy Statement and could demonstrate, for each employer, how their liabilities would be funded over the short, medium and long-term. It could include details of such as:

- key assumptions;
- risk management analysis;
- employer contribution rates.

2.5 The policy aim of the Financing Plan would be to "stabilise pension costs going forward at the same time as moving away from rigid, long term 100% funding targets".

2.6 The CLG also invite comments on a proposal that before setting employer contribution rates following a valuation, the actuary must "take full account of the affordability of employers' liabilities to pay pensions".

2.7 An alternative suggested approach would be to allow an administering authority to set its own funding target that could be other than 100%, "provided this could be sustained and transparently justified by the pension fund administering authority within its published Funding Strategy Statement".

2.8 CLG are also consulting on revisions to employee contributions, in part to make the Scheme more affordable for some of the lower paid, in part to collect more from high earners as "it is now believed that there are many high earners who are paying a proportionately modest amount towards their pension benefits." New contribution rates could apply from 1 April 2010 and could involve replacing the existing seven pay bands as follows:

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	**£100,001+**	10.0%	**+2.5%**
Yield = 6.42% of payroll			

2.9 The CLG's letter also reports that a "later, separate exercise will consider new ways in which the LGPS could possibly be reformed to provide more workforce-focused pension provision for the 21st century".

3. COMMENTS ON PROPOSALS

3.1 General

3.1.1 Our Actuary has submitted a detailed response and analysis of the proposals and this is attached at **Appendix 2.** This provides a good framework for considering the Panel's response.

3.1.2 Comments are given below on the key proposals relating to financing plans, local funding targets and changing employee contribution rates.

3.2 Finance Plans

3.2.1 The Scheme's rules already provide a great deal of flexibility regarding employer contributions, through the guidance that administering authorities give to the Actuaries in the Funding Strategy Statements (FSSs). The aims of FSS are:-

- *"to establish **a clear and transparent fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;*

- *to support the regulatory framework to maintain* ***as nearly constant employer contribution rates as possible;*** *and*
- *to take* **a prudent longer-term view** *of funding those liabilities."*

3.2.2 Using the guidance in the Funds FSS, the Actuary, at the last valuation, takes into account the different types of employer and their different inherent risks in determining employer contribution rates. The main tools available to the Actuary are the deficit recovery period and the duration over which contribution rate changes are phased in. This enabled contribution rate increases for local authorities, the bodies they guarantee and other Government sponsored employers to be kept in general at 1% per annum or less in the 2007 previous valuation.

3.2.3 The valuation report is published on-line, as is the FSS, with the former giving details of key assumptions regarding, for example, inflation and investment returns. Existing practices and documents therefore already cover a lot of the ground that Financing Plans would cover, except that a Financing Plan could allow other than "fund authorities coming forward with full (100%) funding recovery plans". Financing Plans would not of themselves alter investment returns or the costs of benefits.

3.2.4 The Panel, working with the Actuary have always recognised the importance of targeting 100% funding to help maintain the long term affordability of the Scheme and reduce the scope for cross subsidy between generations.

3.2.5 The risk assessment work undertaken by the Actuary and presented to the Panel at its March 2009 meeting was in response to the expectation of substantial deficits arising at the 2010 valuation. This was in line with what CLG envisage incorporating within the financing plan. Such work is regarded as good practice and can be helpful in improving understanding and transparency for both the Panel and employers. However, such changes do not need new regulations, but could be achieved through the existing regulatory framework through revised guidance on the content of the Funding Strategy Statement.

3.3 Local Funding Targets

3.3.1 As an alternative to Financing Plans the CLG suggest the introduction of local funding targets, "which would not necessarily always be set at 100%". However, any watering down of the principle that benefits should be paid for as they are accrued (subject to sensible phasing of increased employer contributions) as commented on above, must inevitably tend to load extra costs onto future taxpayers. Some funds are still grappling with the effects of funding at 75% during the 1990s.

3.4 Changing Employee Contribution Rates

3.4.1 The existing employee contributions bands took effect in April 2008 after a great deal of consultation. To change the rates so soon after the "new scheme" was implemented and with a further consultation paper expected soon regarding new scheme design should require compelling arguments to do so.

3.4.2 CLG suggest that the extent of the lower rate of 5.5% should be reconsidered, as so many members are part-time. It is however *whole-time* equivalent earnings that are taken into account when determining someone's pay band. Consequently a part-timer earning £10,000 a year and working 25% of whole-time would currently be in band 5 (and paying 6.8%), rather than band 1.

3.4.3 In a recent GMPF survey of non-members, of 200 that replied only 25 said that the Scheme cost too much to join (with 100 saying that they were part-time/earned too little to bother becoming a member). There is therefore doubt that increasing employee contribution rates for some of the lower paid by 0.1%, and reducing them 0.3% and 0.5% for others, will have any material effect on the rate of membership.

3.4.4 For those earning more than £75,000 it is proposed that employee contributions increase by either 1% or, for those on more than £100,000 by 2.5%. In determining the employer contribution rate, the key factor regarding pay is the rate of increase rather than the absolute level of pay. Thus if CLG is looking to reduce "inequalities in the pension reward" this could be better dealt with by looking at scheme design, e.g. the determination of final pensionable pay.

3.4.5 If implemented the increases would be broadly off-set by the decreases, and thus the total amount of employee contributions would broadly be the same.

4. CONCLUSIONS

4.1 For understandable reasons the CLG wish to see relatively stable employer costs as an outcome of the 2010 valuations. They propose two new methods, neither of which is necessary unless there is a desire to fund at less than 100%. Historically, the Panel has been supportive of targeting a 100% funding level and it is proposed that this continues to be the case. This is in the context of the "stabilisation mechanisms" considered at the March 2009 Panel which will be the subject of further consultation with the Fund's stakeholders, prior to the completion of the 2010 valuation. Existing Regulations encourage stability and already allow the phasing in of increases in employer contributions. The guidance on the content of the Funding Strategy Statement could be developed to require more risk assessment to be incorporated into the FSS.

4.2 There is doubt that marginally reducing employee contributions would increase the rate of membership, and a risk that increasing employee contributions could have a counter-productive effect. On balance, the concerns raised by CLG could be better dealt with in the second phase of the consultation regarding "New Scheme" design, rather than increasing contributions at this stage. Thus it is proposed that the current rates are maintained.

5. RECOMMENDATIONS

5.1 The Panel's views are sought on the issues raised in the consultation.

5.2 The Director of Pensions responds to CLG reflecting the Panel's views.