

A fair and affordable LGPS

Green paper discussion document by LPFA

Introduction

Within the ongoing debate over the reform of the LGPS, LPFA has called for the setting up of an Independent Commission (The Local Government Pensions Commission) with a remit to ensure its future sustainability and affordability over the long term. This discussion paper sets out more detail about the terms of reference of such a commission and how it might be structured and operate.

The case for an affordable LGPS

An affordable, well structured pension scheme appropriate to its membership and meeting the requirements of its sponsors is a vital element in long term public expenditure, health and welfare policy. Encouraging saving for retirement promotes financial responsibility and ensures the availability of an adequate income in retirement the amount of which is directly related to the demands individuals place on health and welfare provision.

The case is made the question is whether the present statutory structure of the LGPS will be able to ensure it continues to be affordable, appropriate and responsive to the needs of its sponsors into the future. The question is particularly imperative at this time given the challenges of increasing longevity and a shift in the perception of the importance of pensions in the press and public.

Background

At present, the LGPS is a statutory scheme whose trustee is the Secretary of State for Communities and Local Government. It is governed by Acts of Parliament supplemented by complex regulations and Statutory Instruments issued by a specialist team in the Department for Communities and Local Government (CLG). Any changes go through a statutory consultation process involving the employers (Local Government Employers (LGE, part of the Local Government Association (LGA)) and representatives of the employees (Trades Unions). Consultation is then considered by the minister before passing decisions to CLG lawyers for drafting of regulations.

This process is by necessity lengthy, sluggish and has tended to result in tinkering rather than the wholesale addressing of the scheme required to ensure its future sustainability. This is not a criticism of the personnel involved in the process but rather the process itself.

The 2008 Regulations are an example of the results of this process, they were late, did not address the fundamental issues and in some cases are still not complete.

At the centre of the problem with the current situation is asking a political system with understandably short to medium term priorities and pressures to take the long term view necessary for effective management of LGPS issues.

LPFA proposes that the politics be taken out of the LGPS by the establishment of an Independent Commission working within a broad statutory framework of objectives agreed and monitored by the Secretary of State.

In effect the Independent Commission will replace the day to day involvement of the Secretary of State and the CLG. Their role will reduce to one of monitoring the performance of the Commission in achieving an affordable scheme within the agreed framework.

In order to set the Commission up and regulate its operation the Secretary of State would make regulations defining the structure and remit of the Commission and the framework within which it should operate.

Remit and Framework

Its remit will be twofold,

- firstly to determine an appropriate and affordable scheme structure within the framework and
- secondly to manage the affordability of the scheme going forward using the tools available to it and to make recommendations for effective reduction in scheme deficits

In setting up the Commission the Secretary of State will retain powers to:

- Set an overall cap on total contributions to the scheme
- Determine the scheduling of employers and administering authorities within the scheme

The framework within which the Commission would operate would be to ensure that;

- The scheme provides an effective retirement provision that fits within overall government targets for public expenditure
- The scheme operates within overriding regulatory, pensions and fiscal legislation
- The scheme operates within a fair balance of cost between beneficiaries and contributors, both employers, taxpayers and future pensioners;
- The scheme operates within acceptable solvency parameters;
- The scheme is regulated by an appropriate balance of contribution changes and benefit accrual adjustments, not just rely on employer contributions;
- Retirement age reflects wider societal changes and is in line with state retirement safety net provision;
- Indexation of pensions, both pensions in payment and accrued rights, is conditional upon the overall solvency and health of the scheme, in particular the achievement of investment returns

The Commission would be accountable to the Secretary of State by reporting annually on the achievement of the remit with a special report every three years after a statutory triennial valuation.

Structure

The Commission should be structured with a Chairman appointed by the Secretary of State and, say, 10 Board members acting in a trustee capacity for the scheme as a whole. The Board members should be drawn equally from those

responsible for paying for the scheme (employers, taxpayers) and those representing scheme members, be they active employee members, deferred members or pensioners. The Board should be appointed for a fixed 5 year term.

The Commission will be assisted by a secretariat which would be drawn from existing experienced and appropriate CLG, LGE and/or LGPS administration staff.

Determining an appropriate scheme

The key decisions that the Commission will be required to take when determining the scheme would be;

- The basis of the scheme, be it defined benefit final salary or career average or a hybrid DB/DC arrangement
- The balance of cost between beneficiaries and contributors
- The solvency parameters
- The conditional indexation parameters
- The normal retirement age
- Accrual rates

In determining and applying the appropriate scheme the Commission will be obliged to consult interested parties and may take advice from experts it chooses to call before it.

The Commission will be free to make or amend existing scheme regulations and call for whatever information it thinks appropriate from individual funds whenever it feels it appropriate to do so.

The total cost of the appropriate scheme shall not be in excess of any cap set by the Secretary of State.

Maintaining an affordable scheme

As necessary the Commission will determine and publish national standard guidance for triennial valuations including longevity tables and discount rates. In doing so it will take full account of advice requested from the relevant professional bodies.

In line with LGPS valuations the Commission will be required to review the cost of the scheme and if necessary make use of one or more of the following tools to maintain affordability;

- Changes to the balance of cost between employers and members (replacing the proposed cost sharing mechanism)
- Changes to retirement ages
- Changes to future accrual rates
- Conditional indexation for both future benefits and pensions in payment
- Changes to the future structure of benefits

The Commission will also report on the local costs of each scheme and make recommendations to the Secretary of State as to the cost effectiveness of the administration and governance arrangements of the scheme.

As well as managing the ongoing affordability of the scheme the Commission will be required to make recommendations for reducing existing scheme deficits, In doing so it will take account of the views of interested parties and the advice of relevant professional bodies.

Recommendations will be submitted to the Secretary of State who would then make regulations to enact any recommendations s/he chooses to accept.

Impact on LGPS Administering Authorities

The role of the administering authority will continue to be to administer the scheme at local level within the parameters laid down by the Independent Commission. In particular Administering Authorities will retain existing levels of control over investment policy within the parameters set by the Investment Regulations which will continue to be set by the Secretary of State

The main changes will be:

- Indexation of pensions in payment and accrued service will be dependent upon the local performance of the scheme
- Valuation assumptions will need to reflect the standard guidance issued by the Commission rather than be a wholly local negotiation between Actuary and Administering Authority

Statutory implications

As stated the Commission would take over the roles of the Secretary of State in determining many aspects of the scheme. The effects in terms of legislation would be;

- New governance regulations would cover the set up, structure, remit, framework, operation and powers of the Commission together with powers retained by the Secretary of State
- The administration and membership and benefit regulations would be subsumed within the Commission and replaced with trust based scheme rules
- The investment regulations would continue as now.

Conclusion

Setting up the Commission would provide a long term focused forum able to respond effectively to long term cost issues in order to ensure an affordable LGPS which provides levels of benefit appropriate to overall public expenditure, health and welfare targets.

LPFA
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