LGPS: CURRENT ISSUES

MARCH 2015
A BRIEF UPDATE

2014 BUDGET AND NEW PENSION FLEXIBILITY

The mists are starting to clear in relation to the swathes of pension reforms announced by George Osborne during his 2014 Budget statement and how these will impact on the costs of running a Defined Benefit pension scheme such as the LGPS.

There is no doubt that some of the reforms will enable LGPS Funds to possibly manage their running costs – such as the increase to Trivial and Small Sums commutation limits which have massively increased the potential for funds to reduce the costs associated with small pensions.   Having performed analyses on a number of LGPS Funds, in some cases potentially in excess of 30% of existing pensioner and dependant members could qualify for a trivial lump sum in lieu of their pension. This is significant for a Fund if take-up was high as it could lead to material running cost savings and reduction in liability and risk. However, any such exercise would need to be carefully managed and communicated taking into account the various requirements and guidance around bulk liability management exercises given they are now subject to the Code of Good Practice from the Incentive Exercise Monitoring Board although this will be reviewed later this year.

However, other areas of the reforms such as accessing flexibilities via DC vehicles will no doubt increase the burden and

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responsibility of Funds and may potentially lead to an increasing administrative cost.

TPR CONSULTATION: COMPLIANCE AND ENFORCEMENT POLICY FOR PUBLIC SECTOR SCHEMES

TPR has consulted on its proposed approach to compliance and enforcement in relation to public service pension schemes. In broad terms TPR set out how it would identify and assess risk in those schemes and how this will form the basis for its operational activity. TPR also covered its approach to monitoring the schemes through reactive and proactive sources and how a scheme may be investigated by a case team, including the enforcement and other enablement and educative interventions available.

A notable aspect is that the LGPS will now be required to complete a new statutory Scheme Return that will assist TPR in its role. We have responded to this consultation and whilst we are generally supportive, we did make the point that TPR should have regard to the information that is already gathered across the LGPS when finalising its requirements.

TPR CONSULTATION: MEMBER GUIDANCE FOR DB TO DC TRANSFERS

TPR is consulting on guidance to help trustees and managers of funded public service schemes, such as the LGPS, manage the transfer process from 6 April 2015, when the new DC flexibilities are introduced.

This follows on from Government concerns that:

a) members transferring from DB schemes might not fully understand the risks of doing so; and
b) a large increase in older members transferring out of DB schemes could destabilise employer backed DB schemes, or expose the tax payer to additional costs.

Separate to this, work is also progressing centrally around the possibility of applying reductions to transfer values paid out of the LGPS to DC vehicles where members are accessing the Budget freedoms. The ultimate objective is to protect the tax payer. This is likely to be similar to the private sector position based on the funding position relating to the liabilities assessed on an individual transfer value basis. The detail on this is currently being worked through, and we expect more to emerge on this before 6 April.

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GOVERNANCE UPDATE

The final Governance Regulations were laid before Parliament in January and Scheme Managers should now be bringing their work to a conclusion in terms of the requirements to establish a Local Pension Board before 1 April 2015.

The main highlights of the final regulations include:
- only scheme member and employer representatives will have a decisive influence on the LPB,
- joint Boards will be possible (subject to Secretary of State approval) for two or more Administering Authorities who share administration and management activities, and
- Boards can include elected members, although this excludes those who are involved in the operation of the LGPS.

In addition, the Shadow Board, via its Governance and Standards sub-Committee, has issued final guidance, and has developed template Terms of Reference and a Q&A document. Scheme Managers should now be finalising the establishment steps and looking to populate the Boards in the next few months. The initial stage of the implementation is a very important one, as its ultimate success will be driven by those who sit on the Board. Knowledge gaps and training plans will need to be put in place as soon as practicable. Funds should also be reviewing their Governance Compliance Statements in light of the establishment of the LPB to ensure they remain appropriate in light of the changes.

The Board is looking at the merits of greater separation between the Fund and Local Authority, and the Working Group has been looking at options for potential reform. We understand that work is progressing in this area and we expect a recommendation to be made to the Secretary of State once this work has been completed.

TPR's CODE OF PRACTICE & TOOLKIT

TPR has laid before Parliament the final Code of Practice for governance and administration of public service pension schemes due to have legal effect from 1 April 2015. The code provides scheme managers and pension board members with a summary of their key governance and administration duties, standards of conduct and practice we expect in relation to those duties, and practical guidance on how they can comply.

In addition to the Code, TPR has created a dedicated Public service schemes section of their website with various resources available. This includes a Public Service e-learning Toolkit that can be used to learn about managing public service pension schemes and to increase knowledge and understanding of the key areas of governance and administration that need to be focussed on. We recommend that all individuals involved with the management of the LGPS should complete this learning toolkit.

PENSION FUND POLICY REVIEW

The Regulations include a number of complex provisions where the Fund needs to develop clear policies on their application e.g. recovery of termination debt from outgoing employers. In order to assist with the future management of the Fund, we recommend that all Funds add the task of reviewing and updating all policies (or developing them where absent) to their business plans.

DATA QUALITY & STATE SCHEME CHANGES

As mentioned previously, data quality has long been a focus of TPR and the Code of Practice for public service pensions lead us to conclude that this will apply equally to the LGPS going forward. To re-emphasise, it is now appropriate to develop the requirements for improving data quality as part of the Pensions Administration Strategy. A further critical aspect of this includes the efficiency of employer-fund payroll channels of communication in the context of auto/contractual-enrolment.

All Schemes should now be registering with HMRC's reconciliation service to assist with the reconciliation of scheme GMP membership records in advance of the State Scheme changes and cessation of contracting-out in April 2016. This is a significant exercise for Funds and the level of resource needed to reconcile these records should not be underestimated. Software providers are assisting in the "data mining" aspects of the reconciliation but resolution of queries often needs to be done on a case by case basis which is very time intensive. At Mercer we have a dedicated team dealing with this for the schemes we administer and would be happy to assist in-house administration teams with this if required.

Furthermore the loss of NI rebates to employers will result in a budgetary burden of 2-3% of pay per annum in some cases which is significant given the ongoing strain in finances. All employers who participate in the LGPS should be made aware of this for budgeting purposes. Employees in the LGPS will see an increase in their NI contributions which will erode their take home pay levels. In addition individuals will also see a change in their State Pension entitlements where their State Pension Age falls on or after 6 April 2016. Careful communication of these issues is important and we would be happy to assist Funds and employers.

DEFICIT MANAGEMENT & KEY PERFORMANCE INDICATORS

The Shadow Board's Deficit Management working group commissioned a project to consider best practice on how LGPS deficits can be managed including consideration of how information should be provided on a consistent basis for benchmarking purposes across Funds. All actuarial firms advising LGPS have input into the process as best they can. On 29 January the Board issued its workplan for 2015 building on some of the initial themes.

The key outputs from the exercise are expected to be a development of:

- a consistent set of parameters to measure funding positions
- certain risk metrics around deficit funding plans, investment risk and governance risk
- guidance on managing employer risk and enhancing security
- guidance on setting contribution plans.

In addition, the Board is looking to consult on the approach to the calculation of exit payments when an employer exits a Fund and the flexibility around the collection of the payments. This will be an interesting area of debate given, essentially, it manages risk on behalf of the taxpayer who would ultimately need to stand behind the liabilities retained in the Fund. Aligning investment and funding strategies to control this risk will become even more important as these liabilities get bigger. We are helping a number of Funds in this area.

Ultimately there could be some level of interventions on Funds perceived as “high risk” in terms of good financial management and governance. This makes the development of sensible metrics crucial to the operation of the LGPS. The Shadow Board has already done significant work on this.

In light of this, the Shadow Board has sought a number of LGPS funds to voluntarily self-assess against a suite of 18 LGPS pension fund key performance indicators (KPIs). These are being developed in order to provide funds with the ability to compare themselves both across the scheme and across time. The indicators will also provide a framework for the National Board to provide support to funds in a targetted manner. We are developing our valuation comparator database to include these metrics.

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Whilst we welcome some of the developments in this area, some of the areas are already well developed in terms of policies and approaches for LGPS Funds. Care needs to be taken that all aspects of good risk management are reasonably recognised and the outcomes are not simply focussed on just the measurement of deficits/league tables.

It is important that Administering Authorities focus on the management of risk by developing a robust long term plan with clear objectives to manage risk and reduce deficits in a sensible way and not focus simply on league tables. As the pension fund contributions become a bigger proportion of decreasing Local Authority budgets, alignment of investment and funding strategies becomes even more crucial. Having the Governance "plumbing" in place to manage risk dynamically and efficiently at a whole Fund and/or employer level when good market positions allow it needs to become a major priority for Funds in the run up to the next valuation. There are a number of ways of approaching this with the best approach being very dependent on the individual Fund in question. We will continue to develop these ideas and solutions (such as our online funding monitoring and asset tracking tool FSM*pro*) and discuss them with our clients.

COST MANAGEMENT

The regulations covering the Government's Cost Management approach have now been enacted. These develop a backstop protection to the taxpayer to ensure that some of the risks associated with pension provision are shared more fairly between employers and scheme members with a view to assisting with the sustainability of the scheme and fairness to taxpayers. The two cost management mechanisms that have been designed are:

1. Treasury employer cost cap process – monitors the value of benefits in the new Scheme over time, based on "model fund" data and Treasury Directions. The Regulations confirm the cost control provisions showing the employer cost notional "cap" set at 14.6% of pay under the HMT process.

2. Internal cost management process – sets an overall future service target cost of 19.5% of pay, with scheme members meeting a third of this cost (so initially the employer element is 13% of pay and the employee element is 6.5% of pay. These can change however due to the 2/3rd and 1/3rd split).

If the HMT and Scheme Advisory Board

processes both require corrective action, then the wording of the Regulations appears to require that the Treasury process is the one which will apply. There is no facility for the Treasury process to be "turned off" in such circumstances, however in our view it would be preferable for the Scheme Advisory Board process to apply instead.

SOFTWARE/SYSTEMS UPDATE

We are working with the other actuarial firms (including the GAD) and Heywood, via the CLASS group, to update and develop standard valuation extracts and reporting templates. When available, these will increase efficiency in accessing data for performing actuarial calculations and "model fund" extracts. Consideration is also being given to valuation extracts for non-Heywood clients. With regard to Early Retirement Strain Costs the other actuarial firms have now agreed with us to maintain the current methodology but to ensure the facility to adopt Fund specific factors is made available. We therefore expect a template for loading such factors to be provided by Heywood which will make the process much more efficient for Funds.

INDIVIDUAL PROTECTION (IP14) APPLICATIONS

Registration for Individual Protection 2014 has been open since August 2014, and HMRC have now started issuing certificates for those who have already submitted applications. The online form can be accessed from HMRC's website at https://online.hmrc.gov.uk/shortforms/form/IP2014 (HMRC have restricted this process to online applications only).

This should be communicated to all Fund employers, so that they can inform those potentially impacted. It is worth noting that although individuals have until 5 April 2017 to apply for IP14, they will need to collate details of all of the UK registered pension benefits that they have built up as at 5 April 2014.

SINGLE FRAUD INVESTIGATION SERVICE BULK TRANSFERS

The bulk transfer of SFIS staff has been progressing and is now at the data collection stage. This is going to involve the transfer of a few hundred staff across England & Wales to the PCSPS, but it is only going to be a handful of people per employer/fund. There have been some discussions between GAD and the actuarial firms about agreeing a common transfer approach.

It is hoped that it can be based on the usual CETV calculations +/- an agreed percentage to reflect funding positions. This approach would mean that the employer and administering authority could deal direct with the GAD/PCSPS on the transfers, as no specific actuarial input would be needed. Whilst unlikely to affect significantly the residual positions / contributions for the employers, we request that numbers and transfer amounts are confirmed to us, so any impact can be allowed for in future calculations.

NEW FAIR DEAL WORKING GROUP

DCLG have formed a working group, made up of the LGA, Trade Unions and practitioners, to consider how the principles of new Fair Deal might apply for the LGPS – in the spirit as it applies to the other public sector schemes. Until this has been formalised, broad comparability options remain a possibility but it should be borne in mind for current negotiations that this could be removed at short notice.
For some Funds we are seeing an increase in these as LAs transition from providers to commissioners of services. Funds may wish to consider holding training sessions for commercial contract managers at the LAs, in order to ensure the outsourcing processes run smoothly.

COUNCILLORS' PENSIONS

We have seen a number of Councils considering alternative benefit provision for their Councillors in lieu of LGPS membership. In terms of pension provision, Newham has recently gone to tender to set up an 'off the shelf' DB arrangement. More commonly, and we consider it a better fit, DC alternatives are being considered. We have experience of setting up sector-wide pension schemes and are looking at ways that the DC market can facilitate cost effective pension benefit provision for Councillors. Our DC specialists are assisting with Councils interested in considering their options further.

TRANSFER CLUB

Cabinet Office have issued an updated Public Sector Transfer Club Memorandum effective from 1 April 2015. It makes reference to 'Inner Club' and 'Outer Club' transfers where the Inner refers to transfers of CARE benefits between public service schemes. Outer Club refers final salary transfers – or those able to accept them (e.g. PCSPS nuvos). The Club makes some changes to how it will work for transfers to and from CARE schemes. This includes the re-establishment of the original in-service indexation level regardless of the in-service indexation of the receiving scheme. This is to be discussed at the Technical Group with a view to providing specific guidance to the whole LGPS community.

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