LGPS: CURRENT ISSUES

OCTOBER 2014
A BRIEF UPDATE

IN THIS ISSUE

2014 BUDGET - TRIVIAL COMMUTATION UPDATE

As reported in our previous notes, the 2014 Budget included significant changes for Defined Contributions (DC) schemes and other changes which affect the LGPS. On 14 October 2014 the Government presented to Parliament its formal Bill on the reforms.

Previously we reported that the Bill goes further than the changes on the Budget and increased the limit on which spouses pensions in payment can be commuted, without reference to benefits in other schemes. The increase in limit from £18,000 to £30,000 has materially increased the scope for Funds to extinguish small pensions without the need to collate details of a member's benefits elsewhere. Noting some LGPS regulatory restrictions, we welcome this widening of the scope, enabling Funds to extinguish small pensions, benefitting them in an operational and financial sense.

The Chancellor announced on 29 September that "People with defined contribution pension savings will no longer have to worry about their pension savings being taxed at 55% on death" and this gained much press coverage. The main changes will only affect members who die with unused Defined Contribution benefits in schemes that allow drawdown, and the effect on members with defined benefits

LOCAL GOVERNMENT PENSION SCHEME CURRENT ISSUES - OCTOBER 2014

It has been a very busy period for LGPS pension funds. After the implementation of the new scheme on 1 April 2014, there remains no let up not least due to the implications of the Spring Budget, the new Governance requirements and further work being done at a national level (including Deficit and Risk Management).

(such as the LGPS) will be marginal. There are a few minor changes such as where a member dies and a DB lump sum is payable (e.g. the balance of the pension guarantee), then their beneficiaries would still receive their payments tax-free as long as the member has enough available lifetime allowance. The Chancellor's announcement does not include the finer details but the Autumn Statement is expected on 3 December, and more details may emerge then.

2014 BUDGET - RESPONSE

The Government published its response to the 2014 Budget consultation. Key highlights were:

- Transfers from private & funded public sector DB schemes (including the LGPS) to continue
- Ban on transfers from unfunded public sector DB schemes to DC schemes.
- Minimum pension age to access benefits will increase from 55 to 57 from 2028 for most schemes.
- IFA advice will be mandatory for transfers from DB schemes (except for those below £30,000).
- Further consultation on allowing DB members to use the flexibilities directly.
- Flexibilities could be extended to AVCs within DB schemes if the regulations/rules allow it.

2014 BUDGET - ADDITIONAL VOLUNTARY CONTRIBUTIONS

The Budget also has potential implications for AVCs (which are a DC benefit) if members are allowed to take them entirely as a part taxable lump sum. We understand that consideration is currently being given as to how LGPS AVCs will operate after the Budget changes. Whilst AVCs are primarily member related contributions, the fiduciary duty to members rests with the Administering Authority. This is in addition to the TPR's recently issued 31 "Quality Features" which it expects to be embedded in all DC/AVC schemes.

This can be considered if we revisit the AVC arrangements currently offered to members and review them once clarity on the treatment is forthcoming.

2014 BUDGET - TRANSFER SAFEGUARDS

In light of the Government's decision allowing transfers from DB funded pension schemes (such as the LGPS) to DC schemes, there is caution about the risks this could pose to funding levels and/or cashflow. Treasury is keen to learn more about this and DCLG have requested information if 5%, 10% or 20% of over 55 non-pensioners took a DC transfer. This opens up a number of considerations (including the possible reduction of transfer payments where funding deficits exist) and so the further consultation has the potential to be a critical one.

PENSION FUND POLICY REVIEW

The new scheme Regulations make a number of variations to certain clauses (eg cessation of an

More locally, current issues that need to be factored into Fund's business plans are the adoption of the new Governance requirements, the review of existing practices and policies (in light of the new scheme), systems updates, and the increasing focus on data quality and reconciliation.

employer's participation) where Fund Policies underpin the application adopted. In order to assist with the future management of the Fund, we are recommending to all Funds that they add the task of reviewing and updating all policies (or developing them where absent) to their business plans.

Have you reviewed your pension fund policies in light of the new Regulations?

GOVERNANCE UPDATE

The DCLG issued its response to the Governance consultation by actually carry out a further consultation on a new set of draft regulations.

A number of changes have been made since the previous set of proposals, and these include:

- establishment and procedures of the Local Pension Board (LPB) to be determined locally
- Elected members are now permitted to become members of the LPB, subject certain exclusions
- Removal of requirement for representative members (employer or member representatives) to form the majority of the LPB
- responsibility of the Scheme Advisory Board (SAB) extended to include “connected schemes”
- all members of the SAB (at least 2 up to a maximum of 12), and the Chairman, are to be appointed by the Secretary of State (having regard to the desirability of equal representation of employers and members).
- the Chairman may, with agreement of SAB, appoint a maximum of 3 non-voting advisory members to the SAB.

Have you considered how the new Governance proposals impact on your local structures?

In addition, the Shadow Board, via its Governance and Standards sub-Committee, have been working with Eversheds developing detailed guidance concerning the establishment and operation of LPBs. This is being consulted upon alongside the Statutory Consultation, and both have deadlines for response of 21th Nov.

We are recommending that Funds consider their position and respond to both consultations accordingly.

As mentioned previously, the Board is continuing to look at the merits of greater separation between the Fund and Local Authority, and we expect more will develop on this in 2015.

DATA QUALITY

As mentioned previously, data quality has long been a focus of TPR and the draft Code of Practice for public sector pensions lead us to conclude that this will equally apply to the LGPS going forward. To re-emphasise that 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.

TPR's DRAFT CODE OF PRACTICE CONSULTATION

TPR has issued an interim report providing details of what views were put forward when responding to the consultation covering the strategy and code that dealt with governing the scheme, managing risk, administration (including information to be provided to members) and resolving issues. Current expectations are that we'll hear more from TPR toward the end of the year.   This could have an impact on the governance guidance produced by the Shadow Scheme Advisory Board as mentioned above.

DEFICIT MANAGEMENT

The Shadow Board's Deficit Management working group has commissioned a project with PwC 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.

The key outputs from the exercise are expected to be:

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

Ultimately there could be some level of interventions on Funds perceived as "high risk" which makes the development of sensible metrics crucial to the operation of the LGPS.

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. Instead, the focus needs to be on management via the Fund developing a robust long term plan with clear objectives to manage risk and reduce deficits in a sensible way for the employers. This could have implications for any risk management framework that is in place or might be introduced in the future.

COST MANAGEMENT

In addition to Governance, the DCLG Statutory Consultation also covers the Government's Cost Management proposals. 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. The draft regulations establish a requirement for the Secretary of State to appoint a Scheme Actuary (anticipated to be the GAD) to carry out actuarial valuations and apply two different mechanisms. Whilst slightly different, these mechanisms have been designed to ensure some sharing of changes in future service cost between members and employers with a view to assisting with the sustainability of the scheme and fairness to taxpayers. The two mechanisms 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.
2. Internal cost management process – sets an overall future service target cost of 19.5%, with scheme members meeting a third of this cost.

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SHADOW BOARD – ILL HEALTH BENEFITS

The Administration & Communications sub-Committee of the Shadow Board have been carrying out a review of the LGPS ill health benefits as a "phase 2" project of the scheme reforms. A number of options around the structure of the benefits and qualification criteria have been identified and the Secretariat is currently liaising with DCLG in order to obtain costings from GAD.

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.

INDIVIDUAL PROTECTION (IP14) APPLICATIONS

Registration for Individual Protection 2014 is now open – the online form can be accessed from HMRC's website as highlighted in our recent NewsAlert. 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.

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 i.e. participation in the LGPS would be mandated with the broadly comparable option being removed. Re-tendering issues and transitional arrangements will also need to be covered. Whilst new arrangements are unlikely to be in place before the end of 2014, we expect DCLG will make progress on this within the next six months. In the meantime, the existing pension protections will continue to apply for local government contracts.

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.

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