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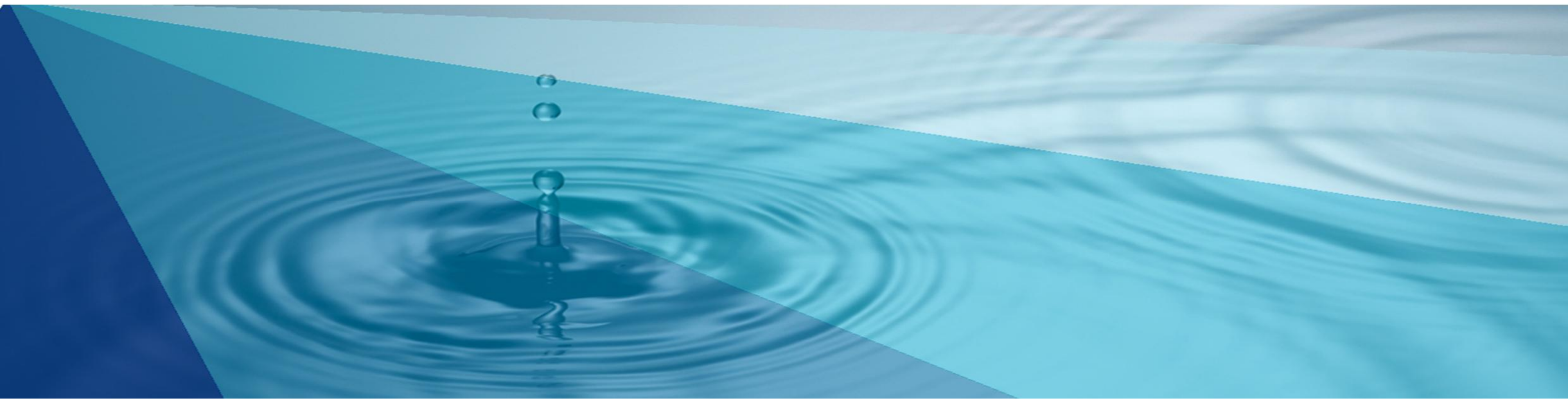

LGPS: CURRENT ISSUES

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A BRIEF UPDATE

2015 GENERAL ELECTION - THE MANIFESTOS OF THE MAJOR PARTIES

At the time of writing the exit polls are predicting a small majority for the Conservative Party. Whilst clarity on how the new Government will influence the pensions landscape generally and for the LGPS may not be known for some time, we provide a summary of the main parties' pension/retirement policy manifesto pledges (in alphabetical order).

Conservative Party

- Maintain the triple lock – i.e. the State Pension will increase by the higher of earnings, inflation or 2.5% p.a.
- Bring in the Single Tier pension – replacing the means-tested Pension Credit
- Reduce tax relief on pension contributions for people earning more than £150,000 p.a.
- Allow pensioners to access their savings so that they can make their own decisions about their money
- Maintain all the current pensioner benefits, including Winter Fuel Payments, free bus passes, free prescriptions and TV licences

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Green Party

- Introduce a Citizen's Pension paid to all pensioners regardless of contribution record. It would not be means tested and would increase in line with the higher of inflation and earnings
- Reduce value of income tax and national insurance relief currently given including reducing annual allowance
- New state earnings-related pension scheme which employers would be obliged to offer and contribute to
- Keep the bus pass and Winter Fuel Payment (and abolish the TV licence)
- Provide free prescriptions to all
- Ensure pensioners living abroad receive the same pension and annual increases as those living in the UK

Labour Party

- Maintain the triple lock
- Restrict tax relief on pension contributions for the highest earners
- Reform the pensions market so that providers put savers first and protect consumers from retirement scams
- Restrict Winter Fuel Payments for the richest five percent of pensioners but there will be no other changes to Winter Fuel Payments, free TV licences and bus passes

Liberal Democrats

- Legislate to make the triple lock permanent
- Continue introduction of Single Tier pension
- Establish a review of a single rate of tax relief for pensions
- Improve Workplace pensions
- Allow people more freedom in the use of their pension and to allow existing pensioners to sell their annuity
- Withdraw eligibility for the Winter Fuel Payment and free TV licences from pensioners who pay tax at the higher rate, but retain the free bus pass for all

Plaid Cymru

- Increase the Upper Earnings Limit on National Insurance contributions to £100,000
- End 40% pensions relief for higher rate tax payers
- Ensure the new Single Tier pension set at least at the rate of Pension Credit
- Support moves to allow early access to pensions
- Oppose increases in State Pension Age and in the retirement age of frontline services
- Investigate flexible pension access for self-employed workers
- Protect free bus passes

Scottish National Party

- Continue the triple lock guarantee
- Support the Single Tier pension
- Review pension tax relief available to wealthiest
- Review planned increase in State Pension Age
- Support auto enrolment and proposals to give pensioners more flexibility, subject to adequate levels of support and advice
- Identify and target unfair, hidden pension charges
- Retain free bus pass, winter fuel allowance and TV licence

UK Independence Party

- Introduce a flexible State Pension window
- Fund a higher standard of independent advice to all pensioners
- Not allow rogue operators to take advantage of pensioners by making it a criminal offence to cold call someone about their pension arrangements
- Keep free bus passes, winter fuel allowances and TV licences for the over 75s and free prescriptions and eye tests for the over 60s, without means testing.

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2015 BUDGET - LIFETIME ALLOWANCE, ANNUITY “CASH INS”

On 18 March, the Chancellor delivered his final Budget before the general election. This Budget saw yet another cut in the standard lifetime allowance (LTA) from £1.25m to £1m effective from April 2016 but no change is proposed to the annual allowance.

This is likely to capture a number of additional long serving and/or highly paid individuals at retirement so communication of the change will be important to allow adequate planning. However, we would still expect the overall numbers affected to be small. We wait to see if there will be a further raft of transitional protections for members who have already built up benefits close to or above the new £1m level.

In addition, Mr Osborne announced a policy to permit pensioners who currently hold annuities to sell the future income from those annuities, although HMT accepts that a market for these may not actually emerge.

The 55% tax charge on cashing-in these annuities will be abolished from April 2016: individuals will be taxed at their marginal rate.

There is currently no detail about how the secondary market will operate and HM Treasury has issued a “call for evidence” consultation on creating such a market. The Chancellor has committed to the consultation to ensure that pensioners seeking to “cash-in” their annuity will be given appropriate guidance and advice.

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 reductions 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. This is because they are now subject to the Code of Good Practice from the Incentive Exercise Monitoring Board although this will be reviewed further later this year. However, other areas of the reforms such as accessing flexibilities via DC vehicles will no doubt increase the burden and 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 UPDATE: MEMBER GUIDANCE FOR DB TO DC TRANSFERS

TPR has published guidance on "DB to DC transfers and conversions" following the consultation it carried out earlier in the year and also its response to the consultation. There are no major changes in its stance but it has taken the opportunity to clarify ambiguities in the draft guidance and align itself with the final regulations that were published after the consultation began.

The guidance 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.

The first concern was partly addressed by the requirement (with exceptions), included in the Pension Schemes Act 2015, that members will have to receive (and pay for) 'appropriate independent advice' from a regulated financial adviser before taking a transfer value of their 'safeguarded benefits' to a 'flexible benefits' arrangement (broadly meaning DB to DC), or before changing any subsisting rights to safeguarded benefits into flexible benefits ('conversion'). Final regulations confirmed that advice will not be required where the initial cash equivalent (i.e. the unreduced transfer value) of the member's entire safeguarded benefits in the scheme is £30,000 or less. Within a month of receiving a request for a transfer value (or receiving a request for information about transfer values, or how to apply for a transfer value) the Fund must let members know that, for a transfer value to be paid to an arrangement providing flexible benefits, the Fund will need to check that, if the initial cash equivalent value of their safeguarded benefits is more than £30,000, the member has received regulated financial advice. The information should include written confirmation from their adviser that he or she is:

- authorised to provide the advice;
- that the relevant advice has been given (i.e. that the advice is specific to the type of transaction proposed);
- the name of the member and the scheme;
- and the adviser's firm's FCA reference number.

The second concern is addressed by the new guidance from the Regulator, which reminds trustees and scheme managers of their statutory powers and the Regulator's previous guidance on transfers and integrated risk management. In particular that in some situations reducing transfer values may be appropriate.

For funded public service pension schemes, reductions to transfer values must be applied in accordance with the Funded Public Service Pension Schemes (Reduction of Cash Equivalents) Regulations 2015.

TPR's CODE OF PRACTICE & TOOLKIT

TPR's final Code of Practice for the governance and administration of public service pension schemes is now live and in-force, after coming into effect on 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 (www.thepensionsregulator.gov.uk/public-service-schemes.aspx) 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.

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TRANSFER CLUB UPDATE

Cabinet Office have issued an updated Public Sector Transfer Club Memorandum effective from 1 April 2015. Club transfers seem set to become substantially more complicated than in the past, and the following issues are worthy of particular note:

- Schedule 7 of the Public Service Pensions Act 2013 includes a provision that members may maintain their final salary link on moving between public service pension schemes if the break in service is less than 5 years.

- The Memorandum clarifies that the mechanism for the member to take advantage of this is by taking a Club transfer between the two schemes.

- The Memorandum changes the current single tier arrangement into a two tier "Outer Club" and "Inner Club" arrangement. The Outer Club is essentially a continuation of the existing provisions for transfers of final salary benefits, whereas the Inner Club deals with transfers of career average benefits. It seems to be envisaged that the Inner Club arrangements will apply only to the main public service schemes, although there does not seem to be an outright ban on other schemes becoming part of the Inner Club if they wished.

- For transfers of career average benefits between Club Schemes, the receiving scheme will be required to apply the paying schemes method of in-service revaluation for as long as the member remains active in the receiving scheme.

- Alongside the Memorandum, a separate note has been produced about how the member's benefits should be valued for annual allowance purposes in the year of transfer. In principle, any increase in the value of a member's benefits due to a pay rise on transfer should now count towards a member's annual allowance, and the note sets out how the calculation should be done. In practice, we expect that for the time being this will need a separate manual calculation.

It is worth noting that the Shadow Board has asked the Chief Secretary to the Treasury whether the LGPS might be permitted to withdraw from the Club. This was largely on cost grounds, against the background of the effect of the Club on the Government's cost cap provisions, although the argument for withdrawing might be strengthened by some of the above points. For the time being, the Chief Secretary did not wish to allow the LGPS to withdraw from the Club, although he did not rule it out at some point in the future.

GOVERNANCE UPDATE

The final Governance Regulations were laid before Parliament in January and Scheme Managers should now be well underway in getting their Local Pension Boards operational. The implementation stage is, in our opinion, 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.

Last month, the Shadow Scheme Advisory Board hosted an event at Local Government House where it gave an update on its work thus far (eg deficit and cost management, communications, scheme reporting, governance including separation etc).

The statutory Board will be established in earnest and it is clear from that event that it is hoped much of the work embarked upon will continue. The outcome of the election, and the leader(s) of the new Government will inevitably shape the future direction of the LGPS.

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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 on an annual basis.

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.

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 as part of the planning for next year's round of LGPS actuarial valuations.

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.

DEFICIT MANAGEMENT & KEY PERFORMANCE INDICATORS

As reported in previous *Current Issues*, 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 and whilst some reservations have been raised the high level objectives are sensible in terms of providing further transparency. On 29 January the Board issued its workplan for 2015 building on some of the initial themes and this was covered at the event held in April.

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 (potentially including minimum employer contribution rates).

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). We have assisted some of the selected funds in responding to this pilot exercise, and we are awaiting further details of how the new statutory Board will take this forward.

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 a favourable market position allows 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 widely reported 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.

AVC ARRANGEMENTS

The Regulator has made clear that it expects private sector occupational pension schemes to have the same governance and oversight for their AVC arrangements as it expects for defined contribution arrangements (and as set out in its Code of Practice 13 “Governance and administration of occupational defined contribution trust-based schemes”).

Whilst not an explicit requirement as yet, it is likely that the Regulator is going to expect public sector schemes to adopt the same standards for associated AVC arrangements.

Additionally, in its Code of Practice for the governance and administration of public service pension schemes the Regulator does make clear that "Where DC or DC AVC options are offered, pension board members should also be familiar with the requirements for the payment of member contributions to the providers, the principles relating to the operation of those arrangements, the choice of investments to be offered to members, the provider's investment and fund performance report and the payment schedule for such arrangements."

The Regulator set out in its Guidance supporting the DC Code a series of quality features it believes a DC scheme should exhibit and suggests an assessment against these features is used to identify any areas where action is needed to bring an arrangement up to the preferred level. Public sector AVC arrangements, such as those in place under the LGPS, should also therefore consider assessing their AVC arrangements against these – indeed, this is our recommended approach at this time. Your usual Mercer consultant can help you with implementing an assessment and identifying any actions needed as a result.

Of course part of the assessment relates to ensuring 'value for money' and suitability for all scheme members and so it is important that as a minimum Funds continue to assess the fund range, security and performance of their AVC arrangements on a regular basis.

COUNCILLORS' PENSIONS

As reported in previous issues, we have seen a number of Councils considering alternative benefit provision for their Councillors in lieu of LGPS membership given their exclusion last year.

Whether this changes under the next Government remains to be seen, although we expect this to be unlikely unless a Labour-led government. Nevertheless, in the lead up to the election, we are aware of a number of Local Authorities considering DC alternatives for their elected members.

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. If this is an area your authority is interested in exploring, once the election outcome is known, please do contact your usual Mercer consultant.

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.

The GAD have responded to the actuarial firms' proposal and have suggested that a "Share of Fund" approach be used, rather than an adjusted CETV as previously proposed to them. The ACA Local Authority sub-Committee is currently considering this counter proposal. Once we have a clear direction we will be in touch to confirm next steps.

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.

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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.

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 understand that a bulletin has been issued by Heywood in this context, but if you do have any questions or issues, please do contact your usual Mercer consultant.

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