EXETER CITY COUNCIL

EXECUTIVE
15 SEPTEMBER 2009

LOCAL GOVERNMENT PENSION SCHEME – DELIVERING AFFORDABILITY, VIABILITY AND FAIRNESS – CONSULTATION PAPER

1. PURPOSE OF REPORT

1.1 To inform the Executive Committee of the details of the Local Government Pension Scheme (LGPS) consultation paper and agree feedback to the consultation as appropriate.

2. BACKGROUND

2.1 The LGPS, as provided in England and Wales, is a statutory, public service, funded, occupational pension scheme which provides guaranteed pension benefits to local authority employees, and to employees of related and admitted employers.

2.2 The Scheme's local administering authorities (Devon County Council for Exeter employees) pay benefits and manage its pension funds within the terms set out in secondary legislation under the Superannuation Act 1974.

2.3 At the 31 March 2007 triennial actuarial valuation, funds' total assets were valued at £132 billion with liabilities totalling £159 billion giving a shortfall between assets and liabilities of £27 billion, or a scheme-wide funding level of 83% (up from 74% in 2004).

2.4 A major scheme reform saw the introduction from 1 April 2008 of a new-look LGPS including revised benefit terms. The Scheme's accrual rate was improved from 1/80ths to 1/60ths with the normal retirement age of 65 years being retained and new ill health provisions and other benefit adjustments within a fixed, agreed cost-envelope. Employees currently contribute between 5.5% and 7.5% of their pay on a set tariff, which yields about 6.4% of total payroll.

2.5 Employers' contributions, fixed until 31 March 2011, are adjusted following the triennial valuation of individual LGPS pension funds. Each individual pension fund authority is required to set an employers' level of contribution to ensure its fund is solvent and able to meet its existing and future liabilities.

2.6 Consultees are invited to respond to this informal consultation exercise no later than 30 September 2009.

3. SCOPE OF THE CONSULTATION

3.1 The consultation sets out initial suggestions for stakeholders to consider as feasible and balanced response to the current stock market impacts on LGPS pension fund liabilities likely to be identified in the forthcoming 2010 valuation exercise. The propositions principally focus on the important regulatory and operational relationship between the actuarial valuation exercise and the requirement on each LGPS administering authority to produce and maintain a Funding Strategy Statement.

3.2 In addition, and alongside the introduction of the new LGPS cost-sharing regime, this is also an opportunity to consider a realignment of the employee member pension contribution tariff, and particularly the proportion of pensionable pay being contributed by higher paid members towards their pension benefits.

4. ACTUAL VALUATIONS AND FUNDING STRATEGY STATEMENTS

4.1 The next LGPS actuarial valuation exercise in England and Wales, required by legislation, takes place as at 31 March 2010. This will determine the new rates of employer contributions from 1 April 2011 until 31 March 2014.

4.2 Many stakeholders believe that unless some adjustments are made to stabilise the treatment of scheme liabilities at the 2010 valuation, and so mitigate any short-term adverse impacts of the current economic recession on the Scheme, the effect on members, employers and taxpayers could be disproportionately significant in terms of increased costs.

4.3 Regulation 36 (6)(b) of the LGPS Administration Regulations 2008 requires that contribution increases for employers in general, following each valuation exercise, should be set. The following paragraphs explore steps to stabilise future scheme costs arising from the 2010 valuation exercise. Liaison will continue with the interested parties over the coming months, particularly on the details of actual proposals and any necessary guidance, including the involvement of the LGPS Policy Review Group.

4.4 Consultees are invited to comment on a proposition involving an amendment to the Scheme regulations, which already includes a specific (but undefined) solvency requirement (Regulation 36(5) of the 2008 Administration Regulations), and modify it with a provision which requires each fund's actuary, first to take full account of the affordability of employers' liabilities to pay pensions and to meet liabilities when undertaking three-yearly fund actuarial valuations and, second, to ensure consistency with an administering authority's funding objectives as set out in its Funding Strategy Statement.

4.5 In practice, this will result in new employer contribution rates being set at each valuation at such a level as to ensure that, over time, sufficient monies are available as required to meet all employers' liabilities.

4.6 Stakeholders have mentioned in recent discussions that a uniform 100% funding target can become artificial and impose significant short term cost pressures on employers during times of economic downturn and falling investment returns. It fails also to take into account the effect on employers' who have to meet cost increases up front, and over the short term, when in every case this is far from justified.

4.7 Although liquidity is a measure of the ability to pay pensions as they become due, solvency is concerned with the capacity and status of scheme employers to meet the pensions promise. That means having sufficient assets to meet all future pension liabilities. At present, this test often becomes a target of 100% funding but, given the strong liquidity of the Scheme, the constitutional permanence of local government and a strong employers' covenant, it is questionable whether fund authorities need to build up what, in effect, amounts to a financial reserve in the process of achieving that solvency level.

5. FINANCING PLANS & LOCAL FUNDING TARGETS

5.1 The first approach would mean that, instead of fund authorities coming forward with full (100%) funding recovery plans to make good all past service deficits, it is suggested that, integral to the preparation of their Funding Strategy Statements, each LGPS administering authority could additionally prepare and maintain a Financing Plan to demonstrate how over the short, medium and then long term, they will fund pension liabilities for their fund and for each of its employer bodies.

5.2 An alternative approach could involve essentially retaining the existing Scheme funding regime but additionally would allow an LGPS administering authority to adopt a long-term funding target which would not necessarily always be set at 100%, provided this could be sustained and transparently justified by the pension fund administering authority within its published Funding Strategy Statement.

5.3 Consultees are invited to comment on both how a proposed financing plan approach could apply, when read in conjunction with the existing Statements of Investment Principles and Funding Strategy Statements, also how to ensure that fund authorities are able to adopt favourable short term positions consistent with their long term pensions liabilities. Alternatively, consultees are invited to comment on whether there is merit in the other approach involving locally selected funding targets, also within the framework established by existing Funding Strategy Statements and Statements of Investment Principles.

6. A REVISED EMPLOYEE CONTRIBUTION TARIFF

6.1 A proposition is also being considered to amend the existing LGPS tariff which set the level of employee contributions linked to their pensionable pay, with new, higher tariffs for members who annually earn in excess of £75,000, together with an extension of the lower rate of contributions for the lower paid.

6.2 The new LGPS Scheme introduced on 1st April 2008 included a new banded contribution arrangement with a top level of 7.5% of pensionable pay for those whose earnings are in excess £75,000.

6.3 An example of the scope of a possible future regulatory amendment is illustrated below. Under this example, members earning over £110,000 per year could pay a contribution rate of 10% of pay, and those below in the next band (earning over £75,000) a rate of 8.5%. Meanwhile, many members earning less than £22,001p.a. would benefit from a lower rate. The table is illustrative at this time and does not represent any firm commitments by Ministers.

Table 1 – Possible New Contribution Tariff

Band	Proposed Pay Range (pay per year)	Proposed Contribution Rate	Current Pay Range	Current Contribution Rate
1	£0 - £15,000	5.5%	Up to £12,600	5.5%
2a	£15,001 - £18,000	6.0%	£12,601 to £14,700	5.8%
2b	£18,001 to £22,000	6.0%	£14,701 to £18,900	5.9%
3	£22,001 to £30,000	6.5%	£18,901 to £31,500	6.5%
4	£30,001 to £40,000	7.0%	£31,501 to £42,000	6.8%
5	£40,001 to £75,000	7.5%	£42,001 to £78,700	7.2%
6	£75,001 to £110,000	8.5%	More than £78,700	7.5%
7	£110,001	10.0%	-	-
Yield = 6.42% of payroll			-	

7. FEEDBACK FROM EMPLOYEE LIAISON FORUM

7.1 The consultation proposals were presented to the Council's Employee Liaison Forum on 31 July 2009 for feedback from staff side. The comments received from the Staff Side are that they see continued investment in pension schemes as essential for reducing pensioner poverty and supporting the wider economy. They also reiterated their view that final salary pension benefits should continue for existing and new employees.

8. RECOMMENDATIONS

8.1 That the Executive note the consultation paper and agrees the principle of seeking measures that both ensure that the LGPS fund has the capacity to meet its full benefit liabilities, whilst mitigating significant short-term fluctuations in employer contributions.

8.2 That the proposals to amend the employee contributions as proposed, be supported.

HEAD OF HUMAN RESOURCES

CORPORATE SERVICES DIRECTORATE

Local Government (Access to Information) Act 1985 (as amended)
Background papers used in compiling this report:

1. None