

ITEM NO: 14

Report To: Pension Fund Management Panel and Advisory Panel

Date: 3 December 2010

Reporting Officer: Peter Morris, Executive Director of Pensions

Subject: **PENSION COMMISSION – PHASE 2 – CALL FOR EVIDENCE**

Report Summary: On 7 October, the Pension Commission published its interim report. The final report will look at options for structural reform. It is due to be published in time for next year's Budget. Lord Hutton, on 1 November asked for evidence and views to be submitted by 17 December, that will assist him in considering the issues.

Recommendations:

- (i) To consider the issues raised in the call for evidence and comment thereon to provide guidance to the Executive Director of Pensions in preparing the Panel's response.
- (ii) To authorise the Executive Director of Pensions to submit a response after consultation with the Chair on the final draft.

Financial Implications:
(Authorised by the Borough Treasurer) There are no financial implications at this stage, but clearly a revised scheme may have significant financial implications in the medium term.

Legal Implications:
(Authorised by the Solicitor to the Fund) The Panel is responding from an administrative authority perspective. Such response may differ from an employing authority or employee response.

Risk Management: The initial report from the Pension Commission envisages structural reform of public sector pensions. An objective of the Panel is to encourage good, secure pension provision. The response to the consultation provides an opportunity to influence this reform. An important risk that needs to be considered is the impact on employees' membership of pension schemes.

Access to Information: **NON-CONFIDENTIAL**

Background Papers:

1. Pension Commission – Interim Report
2. GMPF response to Pension Commission

For further information please contact Peter Morris, Executive Director of Pensions on 0161 342 2952 or email peter.morris@tameside.gov.uk

1. INTRODUCTION

- 1.1 The Government established an Independent Public Service Pensions Commission on 20th June 2010, its terms of reference were “To conduct a fundamental structural review of public service pension provision and to make recommendations to the Chancellor and Chief Secretary on pension arrangements that are sustainable and affordable in the long term, fair to both the public service workforce and the taxpayer and consistent with the fiscal challenges ahead, while protecting accrued rights”.
- 1.2 The Panel made a submission to the initial call for evidence by the Pension Commission. This submission is published on the Fund’s website at www.gmpf.org.uk or a hard copy can be obtained from Loretta Stowers on 0161 3452 2952.
- 1.3 The Commission issued its initial report on 7 October 2010. A short note on the interim report produced by Hyman Robertson is attached at **Appendix 1**.
- 1.4 The interim report set out the landscape around public service pensions and considered the case for reform. The final report will look at options for structural reform. Lord Hutton considers such reform is vital, given concerns around fairness, increases in longevity, management of risk and the need to reduce barriers to different ways of providing public services.
- 1.5 On 1 November 2010, Lord Hutton issued a call for evidence for his final report. A copy is attached at **Appendix 2**. The deadline for responses is 17 December 2010.

2. CALL FOR EVIDENCE

- 2.1 The call for evidence has 25 questions and a general invitation to comment on other issues relating to public service pensions. These fall into 7 sections and some of the questions are highlighted below:
 - (i) Scheme Design
 - What is an appropriate Scheme?
 - (ii) Risk Sharing
 - Who bears what risk and why?
 - How can costs be controlled?
 - (iii) Adequacy
 - What is an adequate level of resource
 - (iv) Employee understanding and choice
 - (v) Pensions and plurality of provision of public services
 - How do we get a level playing field between public and private sector contractors when tendering for contracts?
 - (vi) Administration costs
 - Should the number of funds be rationalised?

(vii) Transition issues

- How should accrued rights be protected?

3. GMPF RESPONSE

3.1 The Panel's normal approach to consultations is to respond from an administering authority perspective. Clearly given the nature of the issues, it is possible for administering authorities to have different views from employers and employees.

3.2 The Actuary will give a short presentation at the Panel to help set out some of the issues on which the Panel may wish to respond.

3.3 A suggested starting point for a Panel response is any new scheme should:-

- (i) be affordable to both the employee and employer;
- (ii) be valued;
- (iii) be considered to be fair;
- (iv) be readily understood;
- (v) provide very good value for money to the employee, employer and the State.

It is likely that there will need to be some trade offs between these points.

3.4 An issue that may attract limited comment from respondents is the value for money issue. This is closely linked to who carries what risk and how the cost of the Scheme is assessed. Lord Hutton's view is that the current basis of costing public sector schemes is underestimating the cost because the discount rate for valuing liabilities is too high.

3.5 For a funded scheme (defined benefit or defined contribution) a "low risk" investment strategy is likely to result in a disappointing pension for the sums invested. By definition a "higher risk" investment strategy is targeting higher returns and thus higher pensions for the same level of contributions, or with defined benefit a lower cost. With such a strategy, returns could be higher or lower and thus the focus on who bears the risk.

3.6 For defined benefit schemes such as the LGPS, the investment risk has been borne wholly by the employer. The investment returns of the last decade have made such schemes very expensive for employers, whereas in the 1980s and 1990s, the cost of delivering the pension promise was much cheaper.

3.7 Thus, if there is a need for "investment risk" to generate targeted benefits, the question is who bears what share of the risk in a defined benefit scheme, and how and when. The Actuary will report on some "safety valves" that he thinks will assist in sharing the risk and thus aiding sustainability. Such an approach can also be applied to other uncertainties such as life expectancy. Work is being undertaken to develop a response for consideration on these matters.

3.8 In the "Scrutiny Report" at item 14, there is a short summary of the main public sector pension schemes. The LGPS is the only funded scheme. All the other schemes are unfunded/pay as you go schemes. Lord Hutton in his first report concluded that the LGPS should remain funded. It is proposed that the Panel's response re-emphasises the benefits of funding whilst recognising the problems of changing the basis of other public sector schemes (i.e. short and medium term affordability).

3.9 In previous consultations, the Panel have been advocates of a "Career Average Revalued Earning" approach to benefit design with an option for final salary, if the employee is prepared to pay for it. Lord Hutton also includes hybrid schemes in his possibilities, such

as “capped schemes” – a defined benefit scheme up to an income level, with a defined contribution scheme for any income over that level. Such an option appears to be attracting some interest. The Actuary will comment on the advantages and disadvantages of such an approach.

- 3.10 A potentially simple solution to the issue of a more level playing field between the public and private sector when tendering for contracts is for the public sector to carry the risk of volatility of cost and the contractor prices his tender on the basis of the future service rate.
- 3.11 The case for rationalising the number of local government pension funds is clearly an important issue on which the Fund should respond.
- 3.12 Transition issues will also be important from an administering authority perspective, in terms of adequate lead times for planning and preparing for change. A particularly important issue will be defining how accrued rights are protected.

4. WAY FORWARD

- 4.1 The Panel's view will be sought at the meeting on the issues raised in the consultation.
- 4.2 A draft response will be prepared reflecting the views of the Panel and agreed with the Chair of the Panel.
- 4.3 A copy of the response will be circulated to members.