

# ITEM NO: 16



<b>Report To:</b>	<b>Pension Fund Management Panel</b>
<b>Date:</b>	6 <sup>th</sup> March 2009
<b>Reporting Officer:</b>	Peter Morris, Director of Pensions
<b>Subject:</b>	<b>REGULATORY UPDATE</b>
<b>Report Summary:</b>	This report provides information about possible changes to the Scheme.
<b>Recommendations:</b>	The Panel is recommended to note the content of this report.
<b>Links to Community Strategy:</b>	The LGPS contributes to reducing pensioner poverty helping to promote good health and social inclusion.
<b>Policy Implications:</b>	None.
<b>Financial Implications: (Authorised by the Borough Treasurer)</b>	If cost-sharing is not introduced into the Scheme, increasing lifespans could make the Scheme unsustainably expensive.
<b>Legal Implications: (Authorised by the Solicitor to the Fund)</b>	Any changes to the Scheme will be notified to members and duly implemented.
<b>Risk Management:</b>	A factor in helping to maintain stability of employer contribution rates will be that increasing costs are not borne solely by the employer.

## ACCESS TO INFORMATION

## NON – CONFIDENTIAL

**This report does not contain information which warrants its consideration in the absence of the Press or members of the public.**

<b>Background Papers:</b>	The Draft Local Government Pension Scheme (Miscellaneous) Regulations 2009.  The Draft Local Government Pension Scheme (Amendment) Regulations 2009.  These documents may be inspected at <a href="http://www.xoq83.dial.pipex.com/whatsnew2008.htm">http://www.xoq83.dial.pipex.com/whatsnew2008.htm</a> or by contacting Ged Dale, Pensions Office, Concord Suite, Droylsden
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## 1. INTRODUCTION

- 1.1 Both sets of the draft Regulations referred to in this report were considered by the Information Services Working Group at its meeting on 23 January 2009.

## 2. THE DRAFT LOCAL GOVERNMENT PENSION SCHEME (MISCELLANEOUS) REGULATIONS 2009

- 2.1 The Regulations propose various detailed technical changes. The two of potential most significant are:

(i) employers being given the power to replace compensatory added years that have already been awarded (and which lead to rechargeable benefits) with augmented membership (which leads to benefits payable from the Fund). Any such change would require extra employer contributions or a capital payment to be made; and

(ii) members with civil partners and nominated cohabiting partners who have membership before 5 April 1988 being able to pay extra contributions to provide extra amounts of dependants' pensions (as membership before this date is not taken into account for these pensions).

- 2.2 The letter accompanying the draft Regulations also notes that the current restrictive rules on pension transfers between LGPS employments can apply unfairly to women, who are more likely than men to have had career breaks. We may therefore see relaxations here in due course.

## 3. THE DRAFT LOCAL GOVERNMENT PENSION SCHEME (AMENDMENT) REGULATIONS 2009

- 3.1 A requirement of the 2008 version of the Scheme is that it must have a cost-sharing mechanism. The Regulations propose how the CLG will be empowered to collect data for subsequent assessment by the Government Actuary's Department (GAD) who will assess the costs of a National Model Scheme. But at this stage there are a number of important assumptions and factors where uncertainty remains.

- 3.2 The CLG propose a very detailed and comprehensive process, with *all* valuation data from *all* funds in England and Wales being provided to GAD every three years. Having received this data GAD will then "carry out an actuarial valuation of the combined LGPS 'Model Fund' " as at 31 March 2010. GAD will then do likewise in 2013 and at subsequent valuations, comparing the results of the current and previous valuation. If the cost of the Scheme has changed this will start a process of assessing how the change should be shared between employer and employee, albeit a key element of the proposals is a maximum employer cost. Options could include changes to:

- benefit design (including pension age) and/or
- member contribution rates

- 3.3 Our Actuary has identified three main cost factors (assuming investment returns are excluded). These are longevity, pay and pensions increases. They favour a simpler approach focussing on these issues.

- 3.4 The Fund's responses on this matter have also favoured a simpler approach. A copy of the response sent to CLG is attached as **Appendix A** proposing that the cost-sharing mechanism be simplified.

#### **4. DATA QUALITY**

- 4.1 Following replies to the consultation about cost-sharing, the CLG has written about the quality of membership data, including the HR and payroll related data sent by employers to the administering authority, and its importance in the effective and efficient administration of the Scheme. The letter is attached as **Appendix B** as an example of where things can go wrong, if a contributor leaves the Fund before retirement and the Pensions Office is not notified of this departure, then records continue to show the member as a contributor rather than a deferred beneficiary.
- 4.2 Partly with the aim of improving the flow of data from employers the informal Charter of Co-operation was converted into a formal Pension Administration Strategy as of 1 October 2008. Performance statistics are monitored and reported to local authorities quarterly. If an employer materially fails to operate in accord with the standards described in the Strategy, which leads to extra costs being incurred by the administering authority, the administering authority may issue a written notice to the employer requiring that these extra costs be met by the employer.

#### **5. RECOMMENDATION**

The Panel is recommended to note this report.

# APPENDIX A

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Date 23<sup>rd</sup> January 2009

Dear Divya,

### **Sustaining the LGPS – Cost Sharing**

Thank you for your consultation paper on “Cost Sharing” of 27<sup>th</sup> November 2008. Our response is from the administering authority perspective.

We continue to support the principle of cost sharing and recognise its importance to the sustainability of the LGPS.

We also recognise the complexity of the methodology and the complexity of the issues it has to deal with. I appreciate that you are not seeking comments on alternatives in this consultation process, however I attach my earlier response and I expand further on the merits of a simpler approach below. I will not repeat the other comments made in the letter but I believe the matters raised continue to merit consideration.

The Policy Review Group, and ultimately Ministers will be reviewing the “dry run of the model fund” based on the 2007 data. Hopefully this exercise will highlight those factors that could have a material impact on the Model Fund Benefit Cost. In the past, I have focussed on the life expectancy assumption and the scope for mitigating the cost of expected improvements by matching the retirement age in the LGPS to the state pension age (i.e. increasing the LGPS retirement age to 66, 67 and 68 etc, in line with the state scheme). The advantage of such an approach is that it deals in advance (or at least mitigates the impact) with the anticipated extra cost of scheme members living longer. It also has the advantage that the rationale is explainable to interested parties.

Our Actuary suggests that the next two most significant cost factors are pay and pension increases (assuming that investment risk continues to be borne by employers). If this is the case, there are easier ways of assessing the impact than collecting data from all funds.

The reasons for suggesting a simpler approach include:

- (i) getting agreement to the underlying assumptions in the model is likely to be challenging
- (ii) administering authorities are likely to struggle to send complete data by 31<sup>st</sup> July. This is because they will have difficulty in collecting the data in time from their employing authorities (particularly where those authorities have changed their payroll systems) and its subsequent “cleansing”

- (iii) if GAD concludes its results by 31<sup>st</sup> December, the time for CLG and Ministers to determine the outcome on the benefit package or employee contributions is very tight if authorities are going to reflect such changes in employer contribution rates unless a formalised approach is set out at the outset.
- (iv) if the economy and financial markets are more supportive leading to investment returns exceeding the actuary's assumptions, it may be difficult to increase employee costs/reduce the benefit package if the Model Fund Cost suggests this should be the case.
- (v) the assumptions made locally could be materially different than those of GAD resulting in very different outcomes at local valuations than would be expected from the national calculations.

All involved in pension funds emphasise the long term nature of pension provision and therefore we should be striving to broadly maintain continuity of cost (and the value of the benefit package) for both employers and scheme members. Changing the benefit package and employee costs every 3 years is not conducive to stability/long termism. Thus it would be useful for the modelling currently being undertaken to look at whether such an objective is achievable. For example, is it possible by reducing or taking out the cost risks of longer life expectancy as outlined above, to set a range for the residual cost (say -1% to +1%) that would not result in any change in employee costs?

If you require any further information or clarification please call me.

Yours sincerely,

Director of Pensions

TBJ Crossley

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11 February 2009

Dear Colleague,

## **LOCAL GOVERNMENT PENSION SCHEME – DATA QUALITY**

The department recently concluded a statutory consultation exercise about future cost sharing arrangements for the Local Government Pension Scheme (LGPS) to provide the initial stages in its full introduction and implementation in England and Wales.

The first steps are to put in place a statutory requirement for each LGPS pension fund authority to provide the Secretary of State with the same data they provide their fund actuary at the time of the actuarial valuation due next at 31 March 2010. This allows a national model fund to be set up from which it will be possible to determine equitably the cost both to employees and employers of future accruals of pension rights and the experience and on-going effects of actuarial valuation exercises.

Responses to the current consultation highlighted issues relating to the provision of quality data. In particular, it has been suggested that LGPS pension funds cannot comply with the originally proposed date of 31 July in the draft regulations because the data would not be in a cleansed format suitable for the proposed statutory cost-share exercise.

This early warning about data quality in the proposed statutory timetable adds weight to administering authorities' insistence about receiving consistent quality data within a reasonable time scale, not just for the new cost share arrangements but also for their normal day to day management and operation of the Scheme, especially when managing administration agreements with employers.

Administering a pension scheme the size of the LGPS is a major and costly business. The most recent data available shows expenditure on administration of the LGPS in England and Wales totalled £113 million. It is vital, therefore, that the processes involved in sharing and providing data (principally HR and payroll information) is managed to the highest standards to protect funds from irregularities (including overpayments and potential fraud) but, perhaps, more importantly to ensure that statutory responsibilities are undertaken in the most efficient and value for money manner.

There is some concern that if this is not necessarily the case it could mean that employers are having to pay a higher, contribution rate than may be strictly necessary since the actuary, for example, is obliged to make more cautious assumptions based on non-validated items. Applying targeted resources to improve the level and standards of data quality in order to provide correct data and within acceptable timescales to the administering authority may actually result in savings for each individual employer.

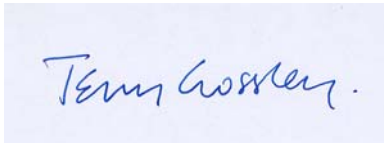
Regulatory steps have been introduced to the LGPS to improve data through the obligation to provide annual benefit statements and more latterly a provision to allow pension funds can enter into formal service level agreements with employers with the aim of improving data quality and controlling costs.

Continuing in this vein, the department, sees it as vital, in the period between now and the next actuarial valuation in 31 March 2010, that positive action is taken at both administering authority **and** at employing authority/employer level to improve the quality and timeliness of data flows and so help to achieve much smoother valuation exercises. This in turn will achieve the benefit of helping to ensure a more accurate and efficient modelling exercise for the cost-sharing process which, of course, becomes an essential step towards maintaining Scheme cost stability, affordability and sustainability.

It would be helpful to know if you were able to advise what steps your authority has taken to put in place an administration agreement with scheme employers, and what steps you propose to take to improve the quality of regular data flows to meet the challenges set out above in the context of the upcoming cost-share arrangements.

I am sending copies of this letter to Scheme pension managers and to members of the Association of Consulting Actuaries Local Government sub-committee.

Yours sincerely,

A rectangular box containing a handwritten signature in blue ink that reads "TBJ Crossley".

**TBJ Crossley**