

**Report of the Chief Executive to the Chair and Members of
the Policy and Resources Panel.**

22nd July 2009

Presenting Officer: Mr Norman Wright
Status: For agreement.

**Local Government Pension Scheme (LGPS) informal
consultation issued by the department of
Communities and Local Government (CLG).**

1. **Purpose**
2. To respond to the CLG consultation paper entitled "LGPS delivering affordability, viability and fairness" which was sent out to all LGPS stakeholders (local authority chief officers) on 25th June 2009.
3. **Recommendations**
4. That members agree to Cleveland Police Authority (CPA) responding to the CLG consultation document in support of the proposition to change the 2008 LGPS Administration Regulations in order to relax the requirement to make up actuarial-defined funding shortfalls in the short term, in favour of a more affordable and longer term solution, which includes funding targets set locally by fund authorities. To further state that CPA does not have a preference with regard to the two options proposed to achieve this outcome. This is further explained in points 13 to 15 below.
5. That members agree to CPA responding to the CLG consultation document by opposing the proposal to change the employee contribution rates in favour of a more progressive structure. This is further explained in point 16 below.
6. **Reasons**

Public Sector Pensions Debate - Background and Context

7. The current debate on the future of public sector pension schemes, which cover some 6.4 million employees, revolves around future liabilities. Recent calculations indicate that the public sector schemes for workers in the NHS, teaching, the Civil Service, the armed forces and the police, have unfunded liabilities amounting to some £1.1 trillion, which is considerably higher than the £800 billion official figure for the national debt. These unfunded liabilities are growing and are seen as unaffordable in the long term. Economic commentators and politicians are putting forward proposals to make these schemes more affordable. These include changing the defined benefits structure to one based on average salary instead of final salary, increasing the employee contributions, or replacing the current defined benefit schemes with defined contribution schemes.
8. The LGPS has 3.7 million members and, unlike most other public sector pension schemes, is a funded scheme. However, the funding shortfall of 17% (£27 billion) identified at the valuation in March 2007 is likely to deteriorate following the next valuation due in March 2010. For example, the value of assets invested in the FTSE all-share index have fallen by over 30% on average since March 2007.
9. The LGPS scheme rules state that each individual pension fund authority is required to set an employer's level of contribution to ensure its fund is solvent and able to meet its current and future liabilities. Thus a large shortfall identified at the 2010 valuation should lead to a large increase in employers' contributions. This would have a direct and detrimental impact upon the budget of local authorities, including Cleveland Police Authority. Hence the CLG consultation document states that it is timely to discuss issues of Scheme funding, cost stability and security.
10. The 2010 valuation will establish the long term funding requirements and the contribution levels for the period April 2011 to March 2014. It is possible, though not explicitly stated in the consultation document, that under current arrangements the required contributions might be unaffordable for the local government employers and taxpayers.
11. The Government's commitment to LGPS is stated as being to provide a scheme that is affordable and sustainable in the long term, which is consistent with the principles of fairness for all taxpayers and between generations. It is recognised that the

Consultation Considerations for Comment

12. The consultation document states that “in assessing the prospects of any possible regulatory changes to the LGPS the Government wishes to maintain a viable and affordable scheme, one that caters for its current and future workforces’ needs and which remains fair to both providers and beneficiaries, as well as to taxpayers who ultimately guarantee the pensions promise.” The consultation document therefore explores steps to stabilise future Scheme costs arising from the 2010 valuation exercise.
13. Consultees are invited to comment on the proposal to amend the LGPS 2008 Administration Regulations. This would relax the funding requirements on employers from setting immediate contribution levels to achieve 100% funding towards achieving this 100% funding over the longer term. The argument here is that pension funds are long term liabilities and a short term deficit should not be seen as a trigger to significantly increase contributions, which might seriously affect affordability and other local government service provision. The consultation document points out that this will better reflect the local funding dynamics for the LGPS scheme, which is strongly liquid and backed by the constitutional permanence of government.
14. This line of argument is sustainable if the assumption is made that the cost pressures for pension schemes will abate as the economy starts to recover; and if the pension liabilities calculations for schemes are much reduced, which could occur following a significant increase in interest rates. This would have the effect of increasing the discount rate for scheme liabilities. On the other hand, with ongoing cost pressures as a result of increased longevity, and with a sluggish economy in the medium term, the balance sheet for pension schemes may deteriorate further in future.
15. There are 2 options defined for achieving the proposed change in the funding regime for the LGPS:-
 - a. Put in place a new Financial Plan for solvency, underpinned by a new Funding Strategy, and the establishment of funding targets set locally by fund authorities. Therefore, instead of

- i. Baseline information on current funds, short and medium term cash flows, and projected changes to funds.
 - ii. Details of employing body contribution rates necessary to meet the long term liability projections, certified by the fund officer responsible for the administration of the fund's affairs and by the appointed actuary.
 - iii. Key assumptions and risk management analysis.
 - iv. Agreement to the Financing Plan by the fund authority's formal pension committee, and proper consultation with all interested parties.
 - b. An alternative approach is detailed whereby the existing funding regime is retained but the rules are changed to allow the LGPS administering authority to adopt a long term funding target which may be less than 100%, provided that this can be sustained and transparently justified. This allows for the long term funding shortfalls to be recovered within a longer time-span, which is more affordable. Valuations will continue to be the cornerstone of funding decisions, but it would be for each locally administered authority to have the final say on questions of affordability, sustainability and fairness to the taxpayers.
16. The consultation document also introduces a proposal to consider a new LGPS cost-sharing regime through the realignment of employee contributions, with a more progressive contribution rate table. This is for agreement in principle only, although there are illustrations of contribution rate changes. For those earning over £75,000 the rate rises from 7.5% to 8.5%, and for those earning over £100,000 the rate rises to 10%, whilst those earning under £22,001 would see contribution rates drop from 6% to 5.5%. Other minor adjustments are also detailed. In this example the effect would be to increase overall employee contributions by some 0.02% of pensionable pay,

Next Steps

17. CLG proposes to issue papers shortly which set out various policy themes for analysis and discussion by Scheme stakeholders about the future direction of LGPS in the medium and long term. This will include discussions on future cost sharing between employers and employees. CLG will arrange further discussions with all stakeholders over proposed amendments to LGPS, with a view to instigating regulatory changes later in 2009-10. CIPFA will be part of these discussions, as will the LGPS Policy Review Group.
18. Consultees are invited to respond to the current consultation exercise by 30th September 2009.
19. **Diversity and Equal Opportunity**
20. The proposal for lower contribution rates for the lower paid employees may help in the recruitment and retention of part time workers, who are predominantly female.
21. **Finance**
22. The funding shortfall of LGPS is likely to rise following the 2010 valuation. The proposals in this informal consultation paper aim to make the funding of the shortfall more affordable to employers in the short to medium term.
23. **Risk Assessment and Sustainability**
24. The main risk for the LGPS is that a continuing and escalating funding shortfall will render the scheme unaffordable to the employer and taxpayer in its current form. Even with the short term mitigation proposed in the current consultation paper, it is possible that a further deterioration in the funding level for the LGPS will continue to threaten the Scheme's existence in the medium to long term. Furthermore, the LGPS is often seen in a similar light to the unfunded public sector schemes, which an increased funding shortfall may emphasise. The political and fiscal pressures to fundamentally reform the current unfunded public sector pension schemes may sweep up the funded schemes that are in deficit, such as the LGPS.

25. **Human Rights**

26. There are no human rights implications within this report.

27. **Conclusion**

28. The CLG consultation paper proposes a solution to a likely short term funding problem. It does little to fundamentally change the affordability of the LGPS in the long term. The proposals for further stakeholder consultation about the future direction of the LGPS will have to tackle the long term affordability issue for employers and taxpayers if the future of the Scheme in its current format is to be protected.

Joe McCarthy
Chief Executive