



## **London Pensions Fund Authority**

### **Response to the recommendations set out in the final report of the Independent Public Sector Pensions Commission headed by Lord Hutton**

#### **Background**

The final report of the Independent Public Sector Pensions Commission headed by Lord Hutton was published on 10<sup>th</sup> March 2011. London Pensions Fund Authority has been fully supportive of the review and the need for sensible change to the Local Government Pension Scheme (LGPS) throughout the process.

As the largest LGPS fund in London and one of the largest in the UK LPFA has taken a lead in the debate surrounding the future of the scheme from hosting a symposium at City Hall and publishing a 'green paper' on the future of the scheme through creating a targeted website ([www.affordable-lgps.org.uk](http://www.affordable-lgps.org.uk)) to submitting a comprehensive response to Lord Hutton's call for evidence in July 2010.

During that time LPFA's chairman and chief executive have addressed keynote speeches at conferences and articles in the trade and national press to the subject of a sustainable and affordable LGPS.

This paper seeks to continue that support for sensible reform by positively commenting on the recommendations in the Commission's final report.

It should be noted that in the main this document refers the LGPS with other public sector schemes only included in our comments when explicitly mentioned.

#### **Summary**

Many of the recommendations contained in Lord Hutton's report were in line with LPFA's initial and final submissions to the commission and which we therefore support, in particular those relating to:

- Core CARE scheme
- Higher retirement age
- Shared risk with automatic regulation
- Common core scheme across public sector
- Retention of funded status for LGPS
- Independent scrutiny
- Improved governance



In our detailed response which follows we have not chosen to comment any further on those recommendations we are in agreement with except where it is necessary in the process of taking an alternative view elsewhere.

There are, however a number of recommendations which we consider bear revisiting in terms of sustainability, affordability and the ability to implement in the timescales proposed. Again our detailed response expands on our concerns however in summary these are:

### **Sections 2 and 5: Sustainability - Increases to employee contributions and access to the scheme**

Although Lord Hutton did not specify the amount by which employee contributions should be increased he did state that there was a case for doing so. The subsequent Treasury proposals to increase employee contributions in the LGPS by an average of 3% whilst protecting the low paid will result in the burden of the required increase falling on a minority of members. We do not believe this to be effective or fair and will not in our view raise the required amount. The potentially **catastrophic impact on cash flows** in the scheme caused by significant opt outs needs to be carefully considered as do the alternatives to contribution increases available in a funded scheme.

The risks highlighted by Lord Hutton with regard to access for non public sector employees ('Fair Deal') do not we believe apply to the LGPS to anywhere near the same extent as with the non funded schemes. Neither is there evidence for such access being a barrier to the movement of services.

Indeed the evidence is to the contrary with the CBI, in their submission to the Commission, calling for a widening of LGPS style access arrangements to the other public sector schemes.

Furthermore the risks to cash flows in the LGPS of removal of access could well outweigh any sort term savings in contract costs.

### **Section 3: Affordability - Preservation of the final salary link for past service**

Although there are good reasons to provide the level of protections envisaged in the report particularly in respect of industrial relations we do not believe the cost of such protections or the administrative complexity has been fully considered. LPFA's actuary estimates that the cost of retaining the link to final salary rather than revaluing past service by CPI could be as much as **£900 million per annum**.

LPFA would propose that previous service is treated as a deferred benefit calculated as at the day before the new scheme comes into operation and subject to the relevant indexation from that point forward. Treating past service in this

FINAL VERSION



way significantly reduces the complexity of the scheme going forward and simplifies the communications required for the move to a new scheme.



## **Sections 6 and 8: Ability to implement - Requirement for primary legislation**

LPFA consider the LGPS to be a success story driven and led by a capable team at Communities and Local Government. We are confident that 95% of the recommendations contained in the report can be implementing using existing legislation and that the centralisation inherent in the proposed primary legislation would be counter to the localism agenda.

Furthermore we do not believe that an implementation date of 2015 is possible if the regulations required for a new LGPS are to be derived from new primary legislation. In this respect LPFA would be happy to work with DCLG officers and, if necessary external legal advisors, to put together an implementation paper setting out in detail how existing legislation would meet all of the important requirements of the new scheme.

Beyond the areas outlined above there are some recommendations containing questions yet to be answered and we have commented on these in our detailed response. In summary these are as follows:

**Section 1: Role of pensions** – whilst accepting Lord Hutton’s assertions of the value of pensions as part of the remuneration package and the need to maximize participation we see little within the report to encourage this view particularly amongst low paid/younger employees.

**Section 2: Tiered contribution rates** – We consider the move from Final Salary to CARE lessens if not removes completely the case for contribution tiers being linked to salary but do see some advantages in linking them to age.

**Section 2: Accrual rate** – No accrual rate is proposed nor any attempt made to reconcile the rate with the aspiration to meet Lord Turner’s benchmark for income in retirement. We have included a number of options here which also take on board alternatives to contribution increases.

**Section 2: Deferred revaluation rate** – No recommendation made despite Average Earnings/CPI being recommended in other areas. We would recommend CPI is used.

**Section 5: Common Framework** – Although not seeking to reopen the debate over one public sector pension scheme which we do not support we do see the benefits of revisiting a closer relationship between the LGPS and Firefighters (and perhaps Police) schemes.

**Section 6: Structure** - LPFA support the scheme and fund level boards proposed (together with the scheme level policy group). However we recognize there are question marks over the suitability/adaptability of the current fund level pensions



committee structure to fulfill the role set out and have proposals to make on the role and make up of the scheme level board.

**Section 7: Administration** – We would argue that standards and benchmarks be set as principles of best practice rather than attempting to compare apples with pears. Also although being generally in agreement with the recommendations avoiding compulsion we would question if London is not a special case.



## Section 1: The role of public sector pensions (Recommendations 1, 2 and 3)

**Recommendation:** The Government should make clear its assessment of **the role of public service pension schemes**. Based on its framework of principles, the Commission believes that the primary purpose is to ensure adequate levels of retirement income for public service pensioners (Recommendation 1).

**Recommendation:** Pensions will continue to be an important element of **remuneration**. The Commission recommends that public service employers take greater account of public service pensions when constructing remuneration packages and designing workforce strategies. The Government should make clear in its remits for pay review bodies that they should consider how public service pensions affect total reward when making pay recommendations (Recommendation 2).

**Recommendation:** The Government should ensure that public service pension schemes, along with a full state pension, deliver at least **adequate levels of income** (as defined by the Turner Commission benchmark replacement rates) for scheme members who work full careers in public service. Employers should seek to **maximise participation** in the schemes where this is appropriate. Adequate incomes and good participation rates are particularly important below median income levels (Recommendation 3).

### LPFA response 1

#### 1.1 Overview

Whilst accepting Lord Hutton's assertions of the value of pensions as part of the remuneration package and the need to maximize participation we see little within the report to encourage this view particularly amongst younger and lower paid employees.

The evidence provided in July of last year from a number of sources including the Local Authority pension funds and the NAPF was that the value of employer provided pensions including the LGPS is not appreciated by younger and/or lower paid employees. Indeed amongst younger employees (now referred to in the press as "the ostrich generation") the very concept of pensions is seen as a negative and certainly not in the same light as mortgages, ISA's and other forms of savings.

The view of the low paid is that saving for pensions not only removes very necessary disposable income in the present but could also be negated by the loss of means tested benefits in the future. As a measure of the possible scope of this view a report by the New Policy Institute estimated that almost 50% of local government employees qualify for some form of income support (the vast majority being part time workers).

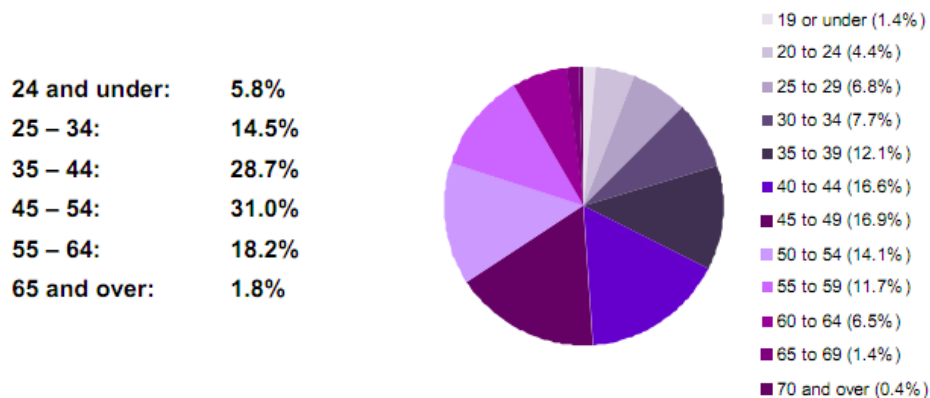


*Thousands of Local Government Employees Eligible For Tax Credits*

	<i>WTC only</i>	<i>WTC and CTC</i>	<i>CTC only above flat rate</i>	<i>Others with children</i>
<i>FT Women</i>	40	5	20	60
<i>PT Women</i>	95 - 160	55	75	170
<i>Total Women</i>	135 - 185	60	95	230
<i>FT Men</i>	50	10	25	30
<i>PT Men</i>	5 - 25	10	10	5
<i>Total Men</i>	55-75	20	35	35
<i>All FT</i>	90	15	45	90
<i>All PT</i>	100 - 185	65	85	175
<i>All Total</i>	190 - 275	80	130	265

Source New Policy Institute (WTC Working Tax Credit CTC Child Tax Credit. Total eligible for one or more benefit 750,000)

With regard to younger employees the issue may not be so much the effect on disposable income but the very concept of putting aside earnings for a point 30 to 40 years into the future when they how much more immediate financial issues to be dealt with. The pensions 'brand' is therefore not appealing to the over 20% of the workforce who are under 34 (as shown by the chart below taken from the *Local Government Employers Workforce Demographic Report 2009*)





**1.2 Increasing the appeal**

LPFA would therefore propose that the opportunity of a new scheme is taken to review the composition and packaging of the LGPS in order to increase the attraction for these important employee groups. Such a review could include:

- A targeted rebranding of the LGPS to minimize the pensions element whilst enhancing the benefits of employer contributions and tax relief
- Introducing a requirement for total reward statements to emphasise the context and value of the LGPS within the whole package
- Introducing low start, age related contributions (coupled with variable accrual rates to ensure they are actuarially neutral)
- Setting a minimum ‘pay floor’ for contributions in line with the requirements of the DWP’s proposals for auto enrolment.
- Exploring ‘blue sky’ ideas such as an LGPS lottery, the ability to pay extra for limited early release or other ways to enhance the appeal for those some way off retirement.

**1.3 A salary floor**

Looking in particular at the salary floor the standard of adequacy set by Lord Hutton (the Turner Commission benchmark replacement rates derived from both state and occupational pension) would be 80% for those earning less than £11,000 per annum.

**Table C.6: Pensions Commission benchmark replacement rates**

Gross income	Gross income (approximate 2011 terms)	Benchmark gross replacement rate (%)
Less than £9,500	Less than £11,000	80
£9,500 - £17,499	£11,000 - £20,499	70
£17,500 - £24,999	£20,500 - £29,499	67
£25,000 - £49,999	£29,500 - £58,999	60
£50,000 and above	£59,000 and above	50

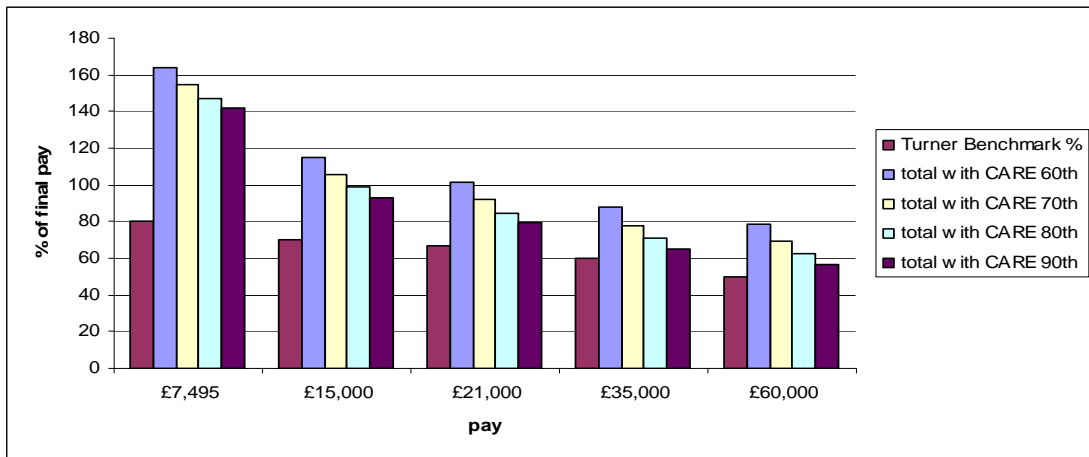
*Source: Pensions Commission (2004), Pensions: Challenges and Choices – The First Report of the Pensions Commission.*

Table taken from final report of commission

For those at or below the DWP proposed lower limit for auto enrolment (£7475) the proposed flat rate state pension of £140 per week (estimated to be in place by 2015/16 and therefore in line with timings for the new LGPS) would provide more than that amount without any additions required by the occupational scheme.



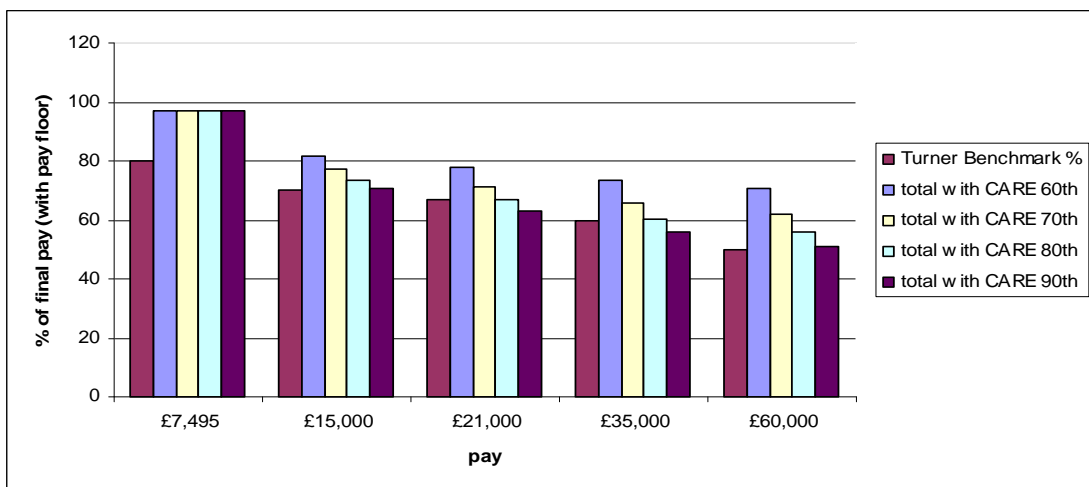
The chart below shows the total pension (including state pension) as a percentage of final pay for a 60<sup>th</sup>, 70<sup>th</sup> 80<sup>th</sup> and 90<sup>th</sup> accrual scheme.



Assuming 40 years membership with average increases in earnings.

As can be seen from the chart all overtake the Turner benchmark at all accrual rates. However the differences in the proportion of 'excess' varies with the lowest earners getting over 140% of final salary whilst those on average earnings (£21K) getting only 79%. It seems counterintuitive for a taxpayer backed pension scheme to provide for a total income on retirement (when added to the taxpayer funded state pension) of over 140% of salary.

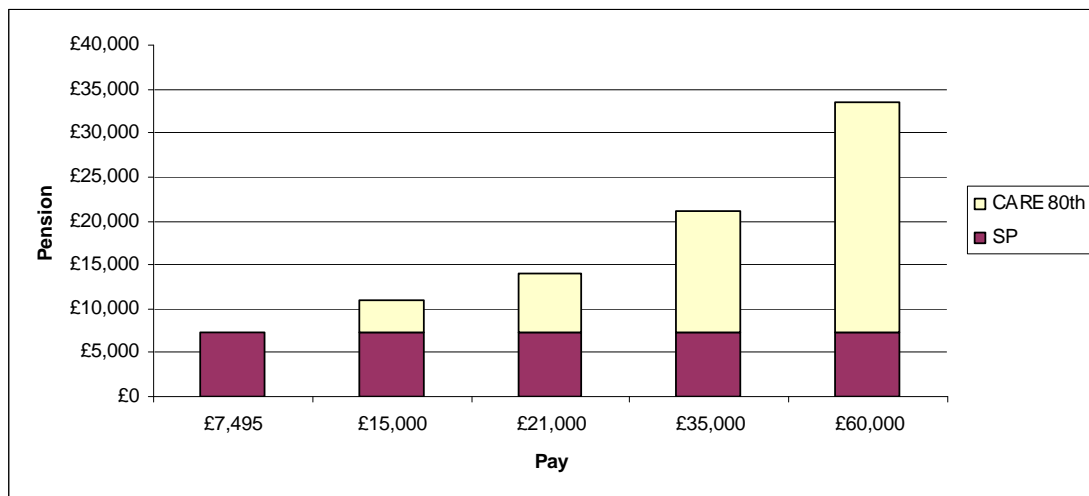
So what happens if we introduce a salary floor? As the chart below shows all can meet or exceed the benchmark at some accrual level but the differences in the proportion of excess is very much smaller.





The pivotal point for the LGPS is the average salary of £21,000. Introducing a pay floor with an 80ths accrual rate gives someone at this level 66.82% (Turner benchmark 67%). The range would be 97.13% of final salary for the lowest earner up to 55.89% for the highest.

The above charts show how the benchmark for other pay levels compares with total pension after 40 years with the same accrual rates whilst the chart below shows how the total pension for 80ths accrual is split between SP and LGPS.



Introducing such a salary floor would result in loss of employee contributions but this would be more than offset by the corresponding reduction in employers' contributions (average 6.4% employees against an average of 13.6% employers)

Therefore if the LGPS pensionable payroll is £30b and membership is 1.6m then the net saving to employers of a 7.2% reduction in contributions on pay below £7495 could be anything between £400m and £800m per annum depending on the number and range of salaries below £7495.

It may however be that a case could be made for using some or all of those savings to provide a form of free low accrual and/or ancillary benefits such as life cover and limited health cover. Such a move would encourage the concept of pensions for the very low paid by offering a form of free membership for pay up to the floor level. For example if half the savings were used a pension based on an accrual rate of 200ths for pay below the floor could be included at no cost to the individual. We believe that such an arrangement would be far more effective in encouraging the concept of saving for retirement than the alternative tiered contribution rate based on salary (see 2.2.2)



## Section 2: Scheme design (Recommendations 5b, 7, 8, 9 and 10)

**Recommendation:** The Government should continue to provide a form of **defined benefit pension** as the core scheme design (Recommendation 5b).

**Recommendation:** A new **career average revalued earnings (CARE) scheme** should be adopted for general use in the public service pension schemes (Recommendation 7).

**Recommendation:** A single benefit design should apply across the whole income range (Recommendation 9a).

**Recommendation:** Post-retirement, pensions in payment should be indexed in line with prices to maintain their purchasing power and adequacy during retirement (Recommendation 8b).

**Recommendation:** Pension benefits should be uprated in line with average earnings during the accrual phase for active scheme members (Recommendation 8a).

**Recommendation:** The differing characteristics of higher and lower earners should be addressed through **tiered contribution rates** (Recommendation 9b).

**Recommendation:** The Government should consider the trade off between affordability and the impact of opt outs on adequacy when setting member contribution levels (Recommendation 9c).

**Recommendation:** Members should have **greater choice** over when to start drawing their pension benefits, so they can choose to retire earlier or later than their normal pension age and their pension would be adjusted accordingly on an actuarially fair basis. **Flexible retirement** should be encouraged and abatement of pensions in its current form for those who return to work after drawing their pensions should be eliminated. In addition, caps on pension accrual should be removed or significantly lifted (Recommendation 10).

## LPFA Response 2

### 2.1 Contribution rate increases

Current proposals are to increase employee contributions in the LGPS by an average of 3% whilst protecting the low paid (based on Lord Hutton's assertion that there is a case for increases in employee rates).

LPFA do not believe these proposals to be:



- Fair, as the burden will fall on a minority of members and that some other schemes have rates as low as 1.5% whilst LGPS rates are already as high as 7.5%
- Effective, as the potential for opt at even reasonable levels will negate the possibility of raising the required amount
- In line with the objectives of recommendation 9c
- Sustainable, given the potentially catastrophic impact on cash flows in the scheme caused by significant opt outs.

It should be stated at the outset that we have no argument with the need to raise revenue and reduce public spending given the current economic climate. However it seems to us not enough thought has been given to the alternatives available to a funded scheme like the LGPS. Due to its funded nature, the LGPS could raise the amount required in several different ways, all of which could result in the necessary reduction in employer contributions.

### **2.1.1 Why should alternatives be considered?**

If a hike in contributions leads to significant numbers of staff opting out (say 15-20% as a conservative estimate) then the following outcomes become increasingly all but certain:

- Firstly, higher contributions will dramatically increase the number of employees who opt-out of the scheme and leave even fewer active members to bear the burden of increased contributions, meaning that the target amount will fail to be raised. A recent paper from Barnett Waddingham (LPFA's actuary) estimated that the net yield would be nearer 2%, if 15-20% opted out, rather than the 3% required. It goes without saying that further increases applied to remaining members to try and reach the yield that 3% is designed to obtain would only result in even more opt outs.
- Secondly a reduction in active membership of this scale would have a detrimental effect on scheme cash flows. Currently cash flows throughout the LGPS are positive and are forecast to remain so at least into the medium term. The increased maturity of funds brought about by significant opt outs would radically change that situation. A 2010 Audit Commission report estimated that such reductions in membership would result in the LGPS having to sell assets to pay pensions as early as 2016.

The resulting impact on investment strategy would be significant and would entail a mass migration of funds from equities to bonds as funds are forced into a more defensive stance. At the present time, the LGPS has some £130 billion in assets, with some £80 billion in equities. Probably around £40 billion is invested by the LGPS in UK companies. A major switch from equities to bonds would have a significant impact on stock markets. In addition, actuarial valuations would need



to factor in this de-risking, and the lower investment returns from bonds, which will lead to increased employer contributions, the opposite of the intention. The reasons why an increase in opt-outs would affect scheme finances are as follows:

- lower amounts of employee contributions mean higher amounts of investment income is used to pay existing pensions
- in the event of an economic slowdown the investment income available reduces;
- asset values also fall (because companies are not making as much in profit);
- contributions from employees and employers plus investment income may not be sufficient to meet pension payments;
- in which case assets would need to be sold to meet pension payments at a point in the economic cycle when asset prices are depressed;
- meaning that the Pension Fund funding level quickly reduces, requiring ever higher amounts of employer contribution.

As schemes mature, investment allocations between asset classes need to change to constrain these risks. This generally involves a switch from equities (highly variable income) to bonds or bond like investments (predictable income), but over long periods bonds perform on average about 3% per annum worse than equities. This mitigation technique also increases costs because ultimate asset values are lower and liabilities are discounted by a lower discount rate.

**2.1.2 What are the alternatives to raising contributions?**

As the aim is to achieve the £900 million reduction in local government spending, any method (or combination of methods) that resulted in employer contributions being reduced by that amount would do the job. For example members could be given the option of a lower accrual rate instead of contribution increases. The table below shows the relationship between accrual rates, and contributions. The table below shows the reduction in total cost (or average cost across the scheme membership) of the existing LGPS benefits by reducing the accrual rate.

Retirement Age	Accrual			
	60th	65th	70th	80th
65	0.0%	1.6%	2.9%	5.1%

Total existing cost assumed to be 21% of pay including member contributions.

Thus an “average member” (someone aged around 45), if faced with an increase of 2.9% could opt for a lower accrual rate of 70ths and retain their existing level of contribution.



In concept this is no different or more complicated than the choice members faced in the past when opting for a reduced future lump sum in exchange for a contingent widow's pension. Or more recently with the option to increase contributions in order to purchase previous part time service.

Alternatively a method or combination of methods could be made optional or imposed on all members which could also include a revised pension age.

The following table shows the equivalent reduction in total costs for different accrual rates and pension ages.

Retirement Age	Accrual			
	60th	65th	70th	80th
65	0.0%	1.6%	2.9%	5.1%
66	0.7%	2.2%	3.5%	5.6%
67	1.3%	2.8%	4.1%	6.1%
68	2.0%	3.4%	4.6%	6.6%
69	2.6%	4.0%	5.2%	7.1%
70	3.2%	4.6%	5.7%	7.5%

Thus if our average 45 year old is faced with a contribution increase of say, 3.4% then they could opt for a package of a reduced accrual of 65ths and a retirement age of 68.

These options, which we believe could achieve the desired revenue without mass opt outs, move us into the realm of scheme design and perhaps best demonstrate the disconnection between the current exercise and Lord Hutton's review.

## 2.2 Tiered/staged rates

Under section 1 we proposed a salary floor on the contributions and benefit accrual in order to encourage participation by the low paid. In this response we aim to address contributions in respect of age and/or salary.

### 2.2.1 Age related contributions

In section 1 we stated the need to encourage participation by younger employees. This is necessary for two reasons, firstly to develop the habit of deferring earnings for when you may need them most and secondly because the earlier participation commences the easier it becomes to fund an adequate income in retirement.

Having a low start scheme with contributions increasing over time not only negates the disincentive to save but also places the level of contribution in line with the value placed by the member on the benefits to be accrued. LPFA's long experience in the arena of pensions has provided ample evidence that the older the employee the more value they place on their pension and the more they are



willing to fund it. Sadly in many cases that realisation of value comes too late in day to provide the income necessary to fund the income desired.

The lower contribution rates at the start of the process could be combined with lower accrual rates to ensure actuarial neutrality, the importance at this stage being to ensure participation rather than to build up significant benefits.

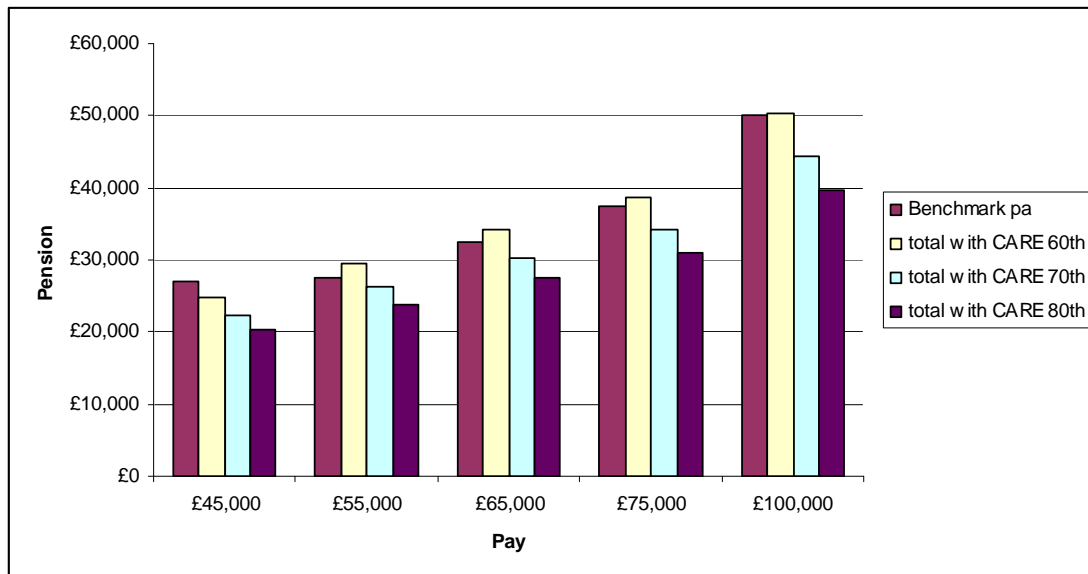
The design of any such age related system should take into account the reality of a changing society where people are starting work later, having families later and therefore having to retire later. Maximum contribution rates should be targeted at the best balance point between perceived value, affordability and maximum benefit to the individual.

**2.2.2 Salary related contributions**

With regards to salary linked tiers these become less relevant in a CARE scheme. Lord Hutton makes the case that final salary schemes disproportionately advantage the ‘high flyers’ at the expense of those whose salaries rise in line with average earnings. The removal of the final salary link removes this advantage and lessens the case for higher earners/high flyers having to pay more into the scheme for that reason.

As seen in section 1.3 the individual on £50,000 is receiving 10% less in terms of final pay then someone on average pay, however that does not take into account the above average pay increased received by high flyers.

The chart below shows the total pension (including state pension) for a member with earnings increases 1.5% above the average for 60<sup>th</sup> 70<sup>th</sup> and 80<sup>th</sup> accrual rates. Apart from the 60<sup>th</sup> rate (in some cases) the benchmark is not met for these individuals.





In relative terms higher earners and especially high/flyers are disadvantaged by a CARE scheme therefore to force the same members to contribute more in relative terms would seem illogical.

If the purpose of a salary related link is to encourage membership amongst low earners we believe our proposal for a salary floor would be far more effective as it specifically addresses the problems particular to low earners (i.e. very low disposable income and fear of loss of benefits).

### **2.3 Accrual**

Lord Hutton has made no recommendations as to the accrual rate to be used in the new scheme but has left it to government to decide in light of the overall agreement regarding the costs of public sector schemes.

However he does recommend that Lord Turner's definition of adequacy be used when considering the level of benefits to be paid. As can be seen in section 1 and above the required accrual to reach Lord Turner's benchmarks in a CARE scheme depend on the individual's experience of salary increases. The CARE scheme is far more likely to meet the requirements for someone who experiences average increases to salary than it will for 'high flyers'.

LPFA's view is that the accrual rates (whether flat or linked to age related contribution tiers) should be set to enable average members to reach the benchmark after an appropriate period of service. For high flyers who may not reach the benchmark replacement rate there should be an option to pay extra contributions in return for higher accrual rates.

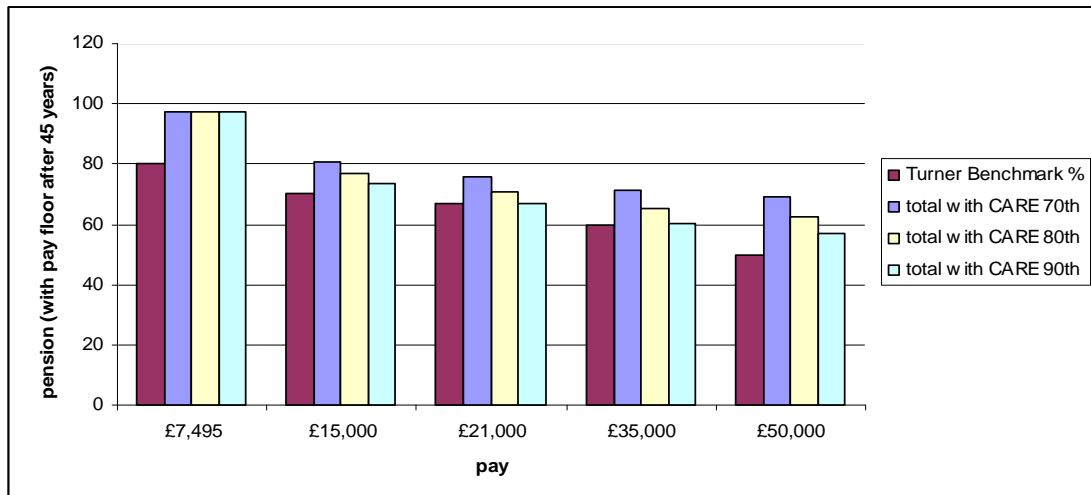
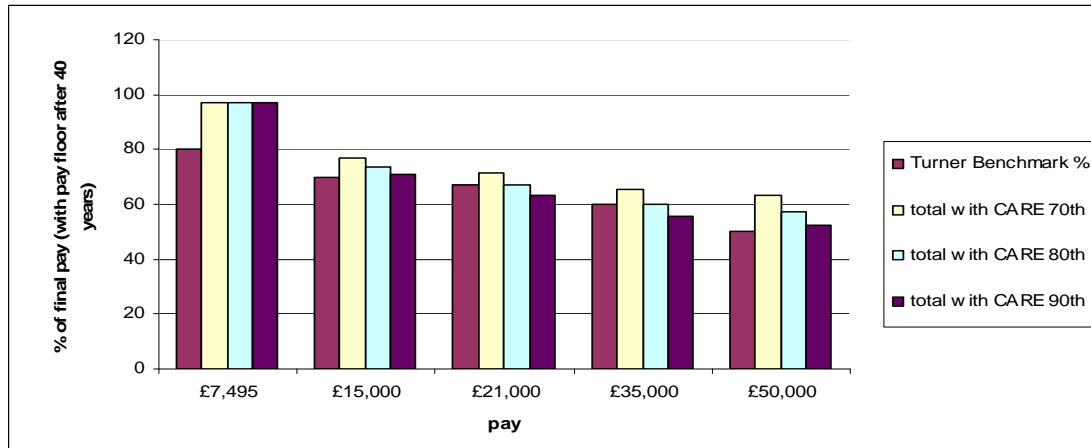
The question that remains what should that appropriate period of service be? The current scheme is based on achieving 2/3rds of final salary after 40 years (40/60ths). The benchmark has now changed to Turner but should the 40 years also change?

In reality Local Government employees are in the LGPS for an average of 17 years. In the LPFA fund only 1.7% of members actually obtained 40 years service. Although we would not argue that a new scheme should be designed to provide Turner benchmarks after 17 years we would argue that a level of reality should be taken into account.

Given that later pension ages are sensible the figure could for example be set at 48 years (assuming retirement age of 68 and entry age of 20). However with the numbers in further education who will not be joining the workforce until their mid 20's plus the reality of how long people are actually in membership 48 may be an unrealistic number to use when providing for a decent retirement income.



Would not a better figure be 40 or even 45? The tables below show total retirement income (including state pension) against Turner benchmark for 70ths, 80ths and 90ths accrual for 40 and 45 year membership. All assume a member with average increases in earnings and a state pension of £140 per week.



In these scenarios the pivotal member on £21,000 gets the same 66.82% of final pay as total pension from both the 80<sup>th</sup> 40 years and the 90<sup>th</sup> 45 years calculation. Therefore either could be selected to provide the required replacement income.

However these figures are based on the member receiving increases in line with average earnings. What if the member had received increases of just 0.25% over average in their career? In this case the 45 90<sup>th</sup> income drops to 62.48% whilst the 40 80<sup>th</sup> although also lower than the benchmark is higher at 63.48%. We are in agreement that final salary unfairly advantages 'high flyers' but to replace it something that disadvantages them to such an extent would seem equally unfair.



It is also in this area that consideration should be given to our remarks in 2.1.2 above in respect of the short term 3% contribution increase proposed. For example a member could opt for either an 80<sup>th</sup> accrual with an average 3% increase or an 85<sup>th</sup> accrual with no increase.

One final point on accrual rates concerns the option to take lump sums. In the unfunded schemes lump sums are a drain on cash flows in any one year as they are effectively pension in advance. It would therefore be understandable if accrual rates were adjusted downwards in order to 'pay for' lump sums in those schemes.

In the funded LGPS the situation is reversed, lump sums far from a problem are a benefit in that they extinguish future long term (and index linked) liabilities in exchange for a immediate payment. The current 12:1 commutation rate is deliberately biased in that the fund benefits over the member in the majority of cases.

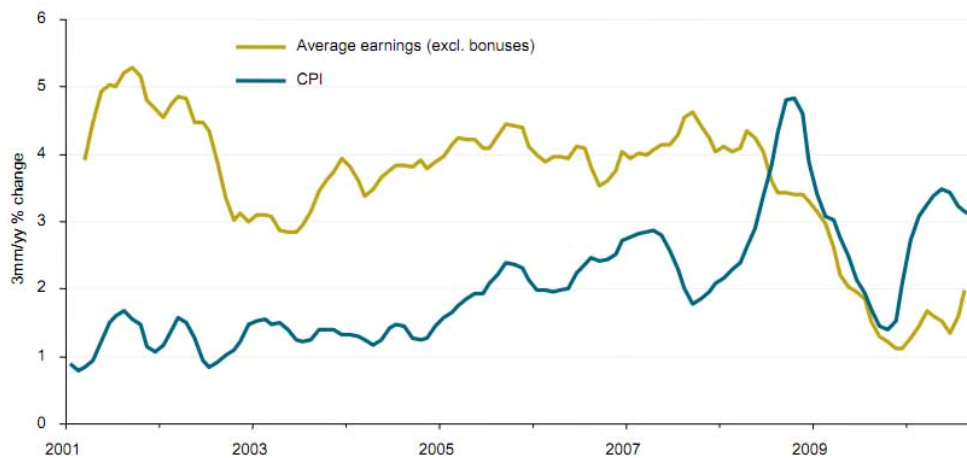
**2.4 Indexation**

The decision to recommend average earnings as the indexation to be used for the revaluation element of CARE is interesting in that it will obviously benefit those members whose earnings increases are below average to the detriment of those above.

Although not disagreeing with the choice of average earnings in principle LPFA would wish to make a number of comments about it:

- Average earning increases are currently below CPI and may remain so in the near future. Whilst this is a 'blip' it may make the scheme a 'harder sell' than it would have been at other times in the economic cycle

UK average earnings (excluding bonuses) vs CPI





- However in the long term average earnings will be higher than CPI (historically by around 2% per annum) which should be taken in account when considering the appropriate accrual rate to be used
- The choice of average earnings coupled with the shift to CARE could be viewed as a disincentive to outperform and achieve higher than average salary increases

The report makes no recommendation as to the index to be used for deferred benefits. LPFA consider that the only reason the index should not be CPI in line with pensions in payment is a reconsideration of the protections for previous service in which case average earnings may be more appropriate.



## Section 3 Accrued rights (Recommendation 4 and 5a)

**Recommendation:** The Government should **honour in full the pension promises** that have been accrued by scheme members: their **accrued rights**. In doing so, the Commission recommends **maintaining the final salary link for past service** for current members (Recommendation 4).

**Recommendation:** As soon as practical **members of the current defined benefit public service pension schemes should be moved to the new schemes for future service** (Recommendation 5a).

### LPFA response

#### 3.1 Final salary link

Although there are good reasons to provide the level of protections envisaged in the report particularly in respect of industrial relations we do not believe this recommendation to be in the best long term interests of the scheme in that:

- Such protections continue the unfair advantages to one sector of the membership spelt out of in other parts of the report.
- The potential 'cost' of the provision could be as much as £900 million per annum.
- Ignoring the undervaluation of past service costs puts at risk the effective operation of future cost control mechanisms by placing the burden of cost on future generations of scheme contributors
- The complexity inherent in the recommendation will increase administration costs and reduce further the levels of understanding for members

The decision whether or not to implement does of course contain significant political implications and repercussions which we do not seek to comment on in this response. However we are concerned that any decisions are taken in full knowledge of the impact on fairness, deficits, future cost control and scheme complexity of the recommendation.

##### 3.1.1 Fairness

In his report Lord Hutton makes a strong case against final salary schemes based on their inherent unfairness. It would therefore seem to be perverse, if the case for unfairness is so strong, to preserve such inequality of treatment by including such a recommendation to retain a final salary link.



Surely a fairer form of protection would be to ensure that the salary in effect at the time the new scheme is implemented is used to calculate benefits accrued up to that point. Such provisions are commonplace in the private sector.

### **3.1.2 Cost**

In our view this recommendation ignores the undervaluation of costs for past service which is the major contributor to current scheme deficits and therefore employer contribution rates.

LPFA's actuary Barnett Waddingham has estimated that removing the link to final salary for past service and linking to CPI instead would reduce deficits by up to 30% to 40% across the LGPS.

Or looking at this another way, if employees were to be given the option of breaking the final salary link for accrued benefits and replacing with CPI increases, there would be potentially a reduction in total cost due to lower deficit contributions required.

The effective reduction in cost would depend on each individual's age and past service – if however all LGPS members opted for this (or it was made compulsory) then Barnett Waddingham estimate that the reduction in total cost for the next 20 years would be of the order of 2.5% to 3.0% of payroll (with some variation across funds). Given a payroll of sum £30b that equates to between £750m and £900m per annum.

Therefore this recommendation would, if implemented, represent a missed opportunity to deal with a significant part of scheme deficits. It would also in our view do considerable damage to the prospects of the scheme remaining affordable in the long term.

If the undervaluing of past service costs is not dealt with at this point then LPFA believe we will be faced with another review of the scheme within a very short time. The only alternatives for such a review will then be to massively increase employee contributions risking mass opt outs or severely curtail the benefits of those yet to enter the scheme risking both of which will result in increases in the numbers of UK employees facing poverty in retirement.

### **3.1.3 Cost Control**

In the next section a mechanism for controlling future costs is recommended, such a mechanism is fundamentally flawed in operation if saddled with a significant cost for past service.

Putting in place a cost ceiling is a concept LPFA fully support and provides the vital risk sharing and safety valve missing from the current scheme. Whatever total cost is agreed upon if employers remain faced with deficit contributions of up 10%-15% on top then the 'deal' on costs falls apart and the total costs spiral beyond what is affordable.



#### **3.1.4 Complexity**

The complexity involved in retaining the link should not be underestimated. The LGPS has evolved over time despite the best efforts of the DCLG into a multifarious beast with a myriad of provisions applying to different periods of service.

Under this recommendation an average member who started in the scheme before 2008 would be subject to three different calculations of pension benefit which may be payable at different ages and under different circumstances.

The challenge in explaining the make up, due dates and the various provisions applying to members will be considerable whilst the costs in terms of such communication together with the systems and skills required to administer them will be significant at a time when budgets for such items are under severe pressure.

This is an opportunity to wipe that particular slate clean and create a scheme which is simpler (and therefore cheaper) for members to understand and funds to administer.

#### **3.1.4 Disconnection with other policy**

Finally it seems incongruous on the one hand to risk serious damage to the scheme for the sake of £900m, whilst on the other pass up the opportunity to significantly reduce the level of deficit in the scheme. Both issues could and should be integrated.

#### **3.1.5 LPFA's proposal**

LPFA propose that the link to final salary for past service be removed. This could be done in a number of ways including:

- Treating service up the date of the new scheme as a deferred benefit to be increased a relevant rate (either CPI or perhaps average earnings in line with active membership)
- Calculating the pension accrued to date and adding it in as a starting value for the new CARE scheme

In either case we are firmly of the opinion that the resulting scheme will be fairer, simpler, more affordable and better placed for sustainability into the long term.



## Section 4: Controlling costs (Recommendations 11 and 12)

**Recommendation:** The Government should increase **the member's Normal Pension Age (NPA) in most schemes so that it is in line with their State Pension Age (SPA)**. However, the link between the SPA and NPA should be regularly reviewed to make sure it is still appropriate, with a preference for keeping the two pension ages linked (Recommendation 11).

**Recommendation:** The Government, on behalf of the taxpayer, should set out a **fixed cost ceiling**: the proportion of pensionable pay that they will contribute, on average, to employees' pensions over the long-term. If this is exceeded then there should be a consultation process to bring costs back within the ceiling, with an **automatic default** change if agreement cannot be reached (Recommendation 12).

### LPFA response

The only comments we would make under this section are to refer to other sections as follows:

- The body/process which will be reviewing the link to state pension age needs to be defined (see section 6)
- The cost ceiling mechanism should not be saddled with a significant past service deficit (see section 3)
- The body/process to consider and if required automatically implement cost reductions needs to be defined (see section 6)



## Section 5: A Common Framework (Recommendations 13, 14, 15 and 16)

**Recommendation:** The Commission is **not proposing a single public service pension scheme**, but over time **public service pensions should move towards a common framework** for scheme design as set out in this report. However, in some cases, for example, the uniformed services, there may need to be limited adaptations to this framework (Recommendation 13).

**Recommendation:** The key design features contained in this report should apply to all public service pension schemes. The **exception is in the case of the uniformed services** where the NPA should be set to reflect the unique characteristics of the work involved. The Government should therefore consider setting **a new NPA of 60 across the uniformed services**, where the NPA is currently below this level in these schemes, and **keep this under regular review** (Recommendation 14).

**Recommendation:** The **common design features laid out in this report should also apply to the LGPS** (Recommendation 15a).

**Recommendation:** It remains appropriate for the Government to **maintain the different financing arrangements for the LGPS** in future, so the LGPS remains funded and the other major schemes remain unfunded (Recommendation 15b).

**Recommendation:** It is in principle **undesirable for future non-public service workers to have access to public service pension schemes**, given the increased long-term risk this places on the Government and taxpayers (Recommendation 16).

### LPFA response

#### 5.1 A common framework

Although not seeking to reopen the debate over one public sector pension scheme which we do not support we do see the benefits of revisiting a closer relationship between the LGPS and Firefighters (and perhaps Police) schemes.

Moving to a common framework of a CARE scheme based on perhaps variable rates contributions and accrual rates provides an opportunity to look at the possibility of some schemes being brought closer together. In this scenario the fact that one person is employed as a local government officer whilst another is a firefighter could be dealt with by differing service types within a scheme rather than being in different schemes.



Both the LGPS and Firefighters schemes are sponsored by DCLG and in many cases administered by the same pensions staff. Currently different systems are used and different communications published to members.

Under a 'fresh start' CARE scheme the only difference between the firefighter and the local government officer could be the retirement age. It would seem counterintuitive to retain two completely separate schemes in such a situation.

It would be both logical and administratively straightforward to have both members in the same scheme with a 'service type' or 'class' flag to indicate the small differences in provision. Such a situation would no doubt result in reduced administration costs due to economies of scale and the avoidance of duplicate effort.

This would probably be done on a purely administrative level with funding streams remaining as they are however consideration could be given to firefighters being in a funded LGPS for the service accruing under CARE.

The costs/benefits of a change in funding would depend on factors such as:

- The treatment of past service (i.e. easier to contemplate if the final salary link is broken)
- The loss in contribution revenue to the existing firefighter's scheme against the potential long term gains of funding future service. The revenue could be split with members and some employers contributions going into the LGPS with the rest funding ongoing pensions

Although sponsored by the Home Office the police scheme is in a very similar situation to the Firefighters in terms of administration with many County Councils providing the service alongside LGPS and Fire. There could therefore also be a case for including the police scheme in such an administrative 'merger'.

## **5.2 Access to the LGPS - overview**

The risks highlighted by Lord Hutton with regard to access for non public sector employees ('Fair Deal') do not we believe apply to the LGPS to anywhere near the same extent as with the non funded schemes. Neither is there evidence for such access being a barrier to the movement of services.

Furthermore although we see some short term contract cost benefits we believe that restricting access would have a detrimental effect on scheme costs and have an undesirable impact on other government policies and spending priorities.

### **5.2.1 Risks of access**

Without wishing to comment on this risk in respect of the unfunded schemes, we would seek to challenge it with regard to the LGPS.



Employers who gain access to the LGPS via Transferee Admitted Body Status (TABS) will have to have undergone

*“an assessment, taking account of actuarial advice, of the level of risk arising on premature termination of the provision of the service or assets by reason of the insolvency, winding up or liquidation of the transferee admission body.” (LGPS Administration Regulations 2008 Reg 6(5)).*

And where that risk is such as to require it, provide an indemnity or bond which

*“must be with—*

*(a) a person who has permission under Part 4 of the Financial Services and Markets Act 2000(3) to accept deposits or to effect and carry out contracts of general insurance;*

*(b) an EEA firm of the kind mentioned in paragraph (5)(b) and (d) of Schedule 3 to that Act, which has permission under paragraph 15 of that Schedule (as a result of qualifying for authorisation under paragraph 12 of that Schedule) to accept deposits or to effect and carry out contracts of general insurance; or*

*(c) a person who does not require permission under that Act to accept deposits, by way of business, in the United Kingdom.” (LGPS Administration Regulations 2008 Reg 6(8)).*

Furthermore each such organisation will be individually assessed at valuation and an employers contribution rate set based on the actual experience of and future assumptions for that employer.

With such safeguards in place we do not consider the risk to the taxpayer to be any worse than before the transfer took place and in some cases that risk could even be less.

Even were the worst to happen and the organisation fall into insolvency, the staff would transfer back to the local authority and the risk would be exactly the same as it was before the original transfer took place.

### **5.2.2 Barriers to movement**

With regard to the provisions being a barrier to movement of services, the experience in local government is that the ability for contractors to have access to the scheme via TABS has if anything improved the ease of transferring staff and made outsourcing services considerably less of a problem than it would have been otherwise.

Indeed in their evidence submitted to Lord Hutton, the CBI asked for the LGPS model to be expanded to all public sector schemes stating that

*“Experience in local government has already demonstrated that an approach of this kind can work successfully. In that sector there is well-established scope for contractors to secure membership of the local government pension scheme*



*(LGPS) in respect of those staff transferred to them as part of contracting arrangements, paying the required employer contribution into the LGPS. While the operation of these admitted body status (ABS) arrangements is not always entirely straightforward, with good sense on the part of both local authorities and contractors the system can work well. The instances where it works best are where private sector providers take responsibility for those risk factors that are under their control, such as the level of pay increases and approvals of early retirement, and other risks inherent to the scheme design and structure remain with the local authority.”*

### **5.2.3 Benefits**

There are without doubt financial benefits to the removal of access. These include;

- The potential for lower contract prices
- A reduction in cost and complexity for contractors
- Potentially a more level playing field

Lower contract prices should be available for all new contracts particularly if, as is claimed, pensions are the second highest cost to contractors after salaries. Contractors will no longer have to provide a myriad of mirror image schemes depending on where the staff transferring originated and the greater costs of the contractor having to provide a Defined Benefit (DB) scheme would be removed.

We would not seek to minimise the benefits of the reductions to contract prices and the greater competition brought about by lower market entry costs especially in these times of financial belt-tightening. Indeed as a third party supplier ourselves we totally understand the desire for and the benefits of a level playing field.

However apart from the short term reductions in contract prices which would no doubt be realised by the removal of access, the other potential benefits are based on assumptions that require a little more questioning before acceptance.

The cost and complexity argument is based on the contractor having to set up run and pay for an equivalent defined benefit scheme. Access to the LGPS via TABS removes everything except the requirement to pay employer contributions. However those contributions are derived from membership of a much larger fund and are therefore less than those the contractor would have to bear on their own.

The level playing field is only such if all parties have the same overheads. Of course it is not fair if contractors' pension costs are so much higher than in-house teams, however it would surely be equally unfair to remove the requirement for DB pensions for contractors whilst retaining it for in-house teams.

### **5.2.4 Costs**



Local government is facing significant financial challenges and will no doubt be seeking the assistance of the private and third sectors in meeting them. We therefore anticipate a large number of local authority staff being subject to TUPE provisions in the coming months and years. Without the ability for contractors to have access to the LGPS via TABS, the scheme faces a sizeable reduction in membership.

A reduction in active membership of this scale would have a considerable and detrimental effect on scheme cash flows resulting in similar impacts as set out in 2.1 with regard to members opting out.

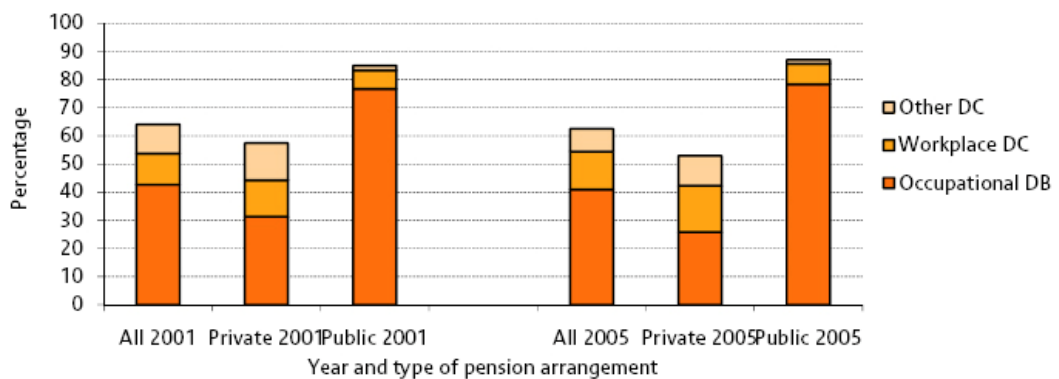
Should the scheme to lose significant membership though both reduced access and opt out due to increased contributions then the cost implications set out in 2.1 could be increased to catastrophic proportions.

**5.2.5 Implications for policy and spending**

The removal of access would probably result in outsourced staff receiving a future pension based on Defined Contributions (DC) which may have negative impact on both participation and accrual. According to an IFS report in 2010:

“..we find that individuals are significantly more likely to be a member of an occupational DB scheme and significantly less likely to be a member of a workplace or other DC scheme..”

Figure 3.1 Pension participation among employees, by sector and year

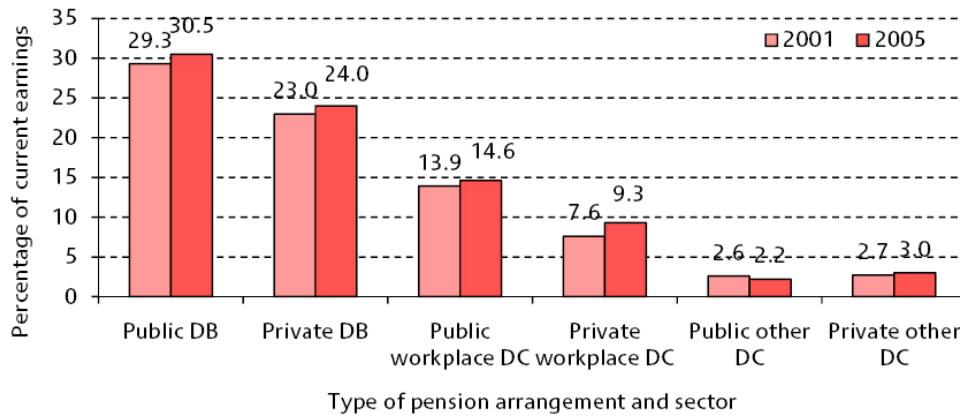


Such a drop in participation in pensions would not be compatible with initiatives by other departments (in particular the DWP) to raise participation and reduce the figure of 7m currently without a pension in the UK. To on the one hand introduce auto enrolment whilst on the other denying access to the LGPS and thereby discouraging participation gives the appearance of a discontinuity in policy.



More worryingly the same report also noted significantly lower annual pension accrual in DC schemes (30.5% of earnings in DB and 9.3% of earnings in DC).

Figure 3.2 Mean value of annual pension accrual to members



Reduced accruals on this scale for those who no longer have access to the LGPS could well lead to significant knock on effects later in life. Evidence is clear that lower incomes result in greater dependence on the state either directly through benefits or indirectly through ill-health, crime or other poverty driven issues. Thus short term savings in contract prices could well result in greater long term spending due to increased demand on services.

These figures are especially worrying when you take into account the fact that historically outsourcing has had the greatest impact on the lower paid sections of the Local Government workforce. There is a great deal of admirable comment in the report about fairness, however to deal a double blow to low paid outsourced workers in that they not only lose local authority employment but also access to the LGPS would seem inherently unfair.



## Section 6: Governance and Transparency (Recommendations 6, 17, 18, 19, 20, 21 and 24)

**Recommendation:** Every public service pension scheme (and individual LGPS Fund) should have a **properly constituted, trained and competent Pension Board, with member nominees, responsible for meeting good standards of governance, including effective and efficient administration** (Recommendation 17a).

**Recommendation:** There should also be a **pension policy group** for each scheme at national level, for considering major changes to scheme rules (Recommendation 17b).

**Recommendation:** **All public service pension schemes should issue regular benefit statements** to active scheme members, at least annually and without being requested and **promote the use of information technology (IT)** for providing information to members and employers (Recommendation 18).

**Recommendation:** All public service pension schemes should **regularly publish data which, as far as possible, is produced to common standards and methodologies and is then collated centrally**. This information should be of a quality that **allows simple comparisons to be made** across Government, between schemes and between individual LGPS Funds (Recommendation 6).

**Recommendation:** Governance and the availability and transparency of information would be improved by government establishing **a framework that ensures independent oversight of the governance, administration and data transparency of public service pension schemes**. Government should consider which body or bodies, including for example, The Pensions Regulator, is most suitable to perform this role (Recommendation 19).

**Recommendation:** When assessing the long term sustainability of the public finances, the **Office for Budget Responsibility should provide a regular published analysis of the long term fiscal impact of the main public service pension schemes** (including the funded LGPS) (Recommendation 20).

**Recommendation:** **Centrally collated comprehensive data, covering all LGPS Funds, should be published including Fund comparisons**, which, for example, clarify and compare key assumptions about investment growth and differences in deficit recovery plans (Recommendation 21).

**Recommendation:** The Government should introduce **primary legislation to adopt a new common UK legal framework** for public service schemes (Recommendation 24).



## LPFA Response

### 6.1 Structure

In overall terms the LGPS is a success story which is, to a great degree, due to both its funded nature and its legal and governance structure. There are improvements which could be made to that structure, and we have made some proposals below, however in doing so we cannot stress enough that whatever the eventual detail the principle of local authorities working under the direction of the Secretary of State for Communities and Local Government is a vital element of that success and should be maintained.

LPFA support the scheme and fund level boards proposed (together with the scheme level policy group). However whilst acknowledging the vital role played by local councilors we recognize there are question marks over the suitability/adaptability of the current fund level pensions committee structure to fulfill the role set out and have proposals to make on the scheme level board

#### 6.1.1 The Scheme Board and Policy Group

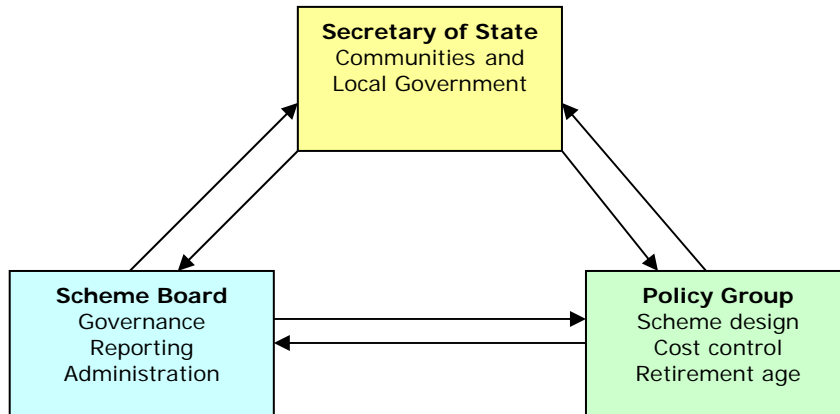
The LGPS currently has a number of scheme level bodies including:

- The Local Government Pensions Committee - part of The Local Government Group (LGG)
- The Policy Review Group (a committee with DCLG, union and employer representatives currently looking at cost sharing)

We would propose that these are reconstituted under the stewardship of DCLG with their membership and terms of reference defined in the scheme regulations to meet the requirements of recommendations 17a and 17b.

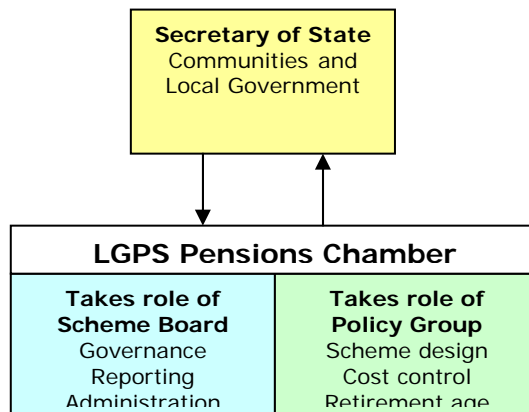
The Scheme Board (which would replace the LGPC) would consist of representatives from members and employers (nominated by the LGG and unions) together with independent experts and an independent chair (nominated by the Secretary of State for Communities and Local Government) following a process of open advertisement). Its role would be to ensure that fund level boards operate to best practice (in particular meeting the requirements of recommendation 18) and to drive scheme wide initiatives in shared services. It would also be responsible for collating and publishing the range of data required by recommendations 6 and 21 in the form of an LGPS Annual Report.

The remit of the Policy Review Group would be expanded to consider and recommend all changes to scheme rules including reviewing the link to State Pension Age and agreeing/implementing the results of the cost ceiling mechanism. We believe that consideration should be given to making regulations which empower the Group to make the necessary and agreed changes without having to resort to secondary legislation.



The Board and Policy Group should along with the Secretary of State for Communities and Local Government form a ‘balance of power’ ensuring that each acts in accordance with the best interests of the scheme. The Board should be able to call the Group to account for its decisions whilst the Secretary of State would have a power of veto over any changes which would increase total scheme costs over those agreed with HM Treasury for all public sector schemes.

A simpler alternative would be the expansion of the PRG in terms of membership and scope to enable it to fulfill all of the tasks set out in Lord Hutton’s recommendations. This pensions ‘chamber’ would have full responsibility for the policy and governance of the LGPS working within parameters set by the secretary of state. The chamber would have a membership including DCLG, LGG, and Unions, plus independent experts (Actuaries, Pension Lawyers, Practitioners) with an independent chair.





The secretariat of the Board and Policy Group or combined 'chamber' could be provided from resources currently in place at LGG and DCLG. Should this be the case then the important role currently played by LGG team in providing guidance, training and communication would need to be preserved in the new structure.

The funding of the Board/PRG and secretariat should be by combination of a subscription paid by all LGPS funds (to incorporate the subscription currently paid to LGG for in respect of the LGPS) with some central government contribution.

### **6.1.2 Fund Boards**

LGPS administering authorities already have in place pensions committees which consider matters of investment, governance and administration at that level. In many ways these committees work very well (e.g. they provide a vital element of local accountability) and therefore should be the basis of any solution.

They are however not perfect and improvements could be made with regard to consistency of expertise and the issue of potential conflicts of interest (whether real or perceived).

Pensions committees consist of local councilors with a mixture of non voting member representatives and investment advisors. Those councilors will change on a regular basis either due to or between elections making the retention of expertise difficult. Furthermore local government standing orders provide obstacles to the provision of voting rights to lay members of council committees.

There is also the issue of a potential (and at times understandable) conflict of interest for voting committee members between protecting the income of the fund and keeping down council tax rates.

In making both of these points we do not seek to undervalue the contribution made by many hard working councilors across the LGPS merely to highlight the difficulties they face in their role.

We would therefore propose that each administering authority is required under the scheme regulations to constitute a board sitting alongside the host authority's formal committee structure. Such a board would have a mixture of members including councilors, member representatives and independent experts all with voting rights whose role would be to act as quasi trustees on behalf of the fund. Careful consideration would need to be given to the balance of members to ensure that local accountability is not lost in the effort to improve the expertise as well as the perceived and real transparency of the body.

In recommending that member representatives would have voting rights LPFA recognise that such a move is only viable should the cost control mechanism ensure that if the investment policies they will be determining are linked to the benefits paid to members.



## **6.2 Primary legislation**

LPFA consider the LGPS to be a success story driven and led by a capable team at Communities and Local Government. We are confident that 99% of the recommendations contained in the report can be implemented using existing legislation (the exception being the common legal framework envisaged by recommendation 22) and that the centralisation inherent in the proposed primary legislation would be counter to the localism agenda.

Furthermore we do not believe that an implementation date of 2015 is possible if the regulations required for a new LGPS are to be derived from new primary legislation. In this respect LPFA would be happy to work with DCLG officers and, others, to put together an implementation paper setting out in detail how existing legislation would meet all of the important requirements of the new scheme.



## Section 7: Administration and rationalisation (Recommendations 22 and 23)

**Recommendation:** Government should set **what good standards of administration should consist of in the public service pension schemes based on independent expert advice.** The Pensions Regulator might have a role, building on its objective to promote good administration (Recommendation 22a).

**Recommendation:** **A benchmarking exercise should be conducted across all the schemes** to help raise standards where appropriate (Recommendation 22b).

**Recommendation:** Central and local government should **closely monitor the benefits associated with the current co-operative projects within the LGPS with a view to encouraging the extension of this approach, if appropriate,** across all local authorities (Recommendation 23a).

**Recommendation:** Government should examine closely the potential for the unfunded public service pension schemes to **realise greater efficiencies in the administration of pensions** by sharing contracts and combining support services, including considering outsourcing (Recommendation 23b).

### LPFA Response

#### 7.1 Standards and benchmarking

The aims of the recommendations (22a and 22b) are to promote good administration and to raise standards. We believe this is best achieved by putting in place a set of principles. The authority would report against these principles on a 'comply or explain' basis in its Pension Fund Annual Report. In this way it would operate alongside the LGPS Governance Compliance statement already in place.

The Principles would set minimum standards within the following areas of administration. We have provided some examples of the kind of standards that could be set within each area.

#### **Accuracy of Date (e.g.)**

Measure and publish performance against the Pension Regulators Data standards  
Publish data accuracy figures from last valuation

Measure and publish %/number end of year errors from employers

Measure and publish accuracy against HR/payroll systems including pensions payroll



**Performance (e.g.)**

Measure and publish on time performance (from receipt of all information) for 'Top 10' cases types  
Measure and publish numbers of cases 'on hold' for more than 6 months  
Measure and publish customer satisfaction levels

**Communications (e.g.)**

Provide an annual benefit statement to active and deferred members  
Publish an annual pensioner newsletter  
Publish an annual actives newsletter  
Publish an annual deferreds newsletter  
Provide a member and employer website/s (with access to records and calculation facilities)

**Complaints (e.g.)**

Have in place a published complaints procedure  
Measure and publish the %/number of and successfully resolved complaints

**Cost and efficiency (e.g.)**

Measure and publish costs of administration  
Measure and publish %/number of electronic transactions

**Training and accreditation (e.g.)**

Publish %/number of staff qualified in pensions administration and at what level  
Publish industry standard accreditations

**Security of Data (e.g.)**

Publish Business Continuity plan and the results of last test  
Publish Data Security policy  
Publish level of accreditation against ISO27001

**7.2 Co-operation and shared services**

Although being generally in agreement with the recommendations avoiding compulsion we would question if London is not a special case.

Having 33 borough funds plus LPFA does not seem a logical structure to provide an efficient local government pension scheme for the capital. Having said that LPFA is very aware of the political implications inherent in questioning the current structure and the strength of the localism argument used to defend the status quo.

LPFA believe that a single fund for London is the logical choice and that issues of local accountability and local access can be dealt with by the sensible application of unitization (allowing large employers to retain control over the asset allocation for their own investments within the overall fund strategy) and regional offices.



The table below show the relative performance over the 8 years for large (over £2b) mid range (£1b to £2b) and smaller (under £1b) funds. Data is taken from the 2010 Audit Commission report *Local Government pensions in England*.

to 31 March	02	03	04	05	06	07	08	09	Average
Larger funds	-0.9%	-17.9%	22.2%	11.4%	24.2%	6.6%	-2.4%	-19.2%	3.0% pa
Mid range funds	-0.7%	-19.9%	24.1%	11.4%	26.0%	7.1%	-3.9%	-21.2%	2.9% pa
Smaller funds	-1.3%	-21.0%	23.6%	10.9%	24.3%	6.5%	-3.8%	-21.5%	2.2% pa
Average fund performance	-1.1%	-20.3%	23.5%	11.1%	24.7%	6.7%	-3.6%	-21.1%	2.5% pa

Source: Audit Commission: data underlying their 29 July 2010 report – “Local government pensions in England”. PwC analysis of data.

The higher performance of larger funds seems to stem from their ability to defend their positions better in the bad years which is probably down to the greater diversification of assets possible in such funds.

The same Audit Commission report also stated that

*‘Fewer larger funds should have greater capacity to develop and oversee thoughtful strategies for balancing risk and reward on behalf of local authorities. Combined funds should be able to attract the specialist staff needed for capital growth. They should also achieve lower fee rates for externally managed investments’*

A previous Audit Commission report *Efficiency challenge: Costs of Administering Local Government Pension Funds in London* (2006) identified administration savings of up to £34m per annum for a single London fund. This figure is backed up by a 2009 **Journal of Pension Economics and Finance** article\* which demonstrated that in the Netherlands administration costs drop significantly for funds over 100,000 members but rise again once funds reach 1M members. The table below is reproduced from the article

Number of participants	Administration costs per participant (Euros)
>100	927
100-1,000	302
1,000-10,000	156
10,000-100,000	86
100,000-1M	28
>1M	33
average	48



\*JACOB A. BIKKER and JAN DE DREU (2009). Operating costs of pension funds: the impact of scale, governance, and plan design. *Journal of Pension Economics and Finance*, 8, pp 63-89  
doi:10.1017/S1474747207002995

This conclusion is particularly relevant in London were all funds have membership numbers less than 100,000.

Although both Audit Commission reports go on to point out the same issues as we have highlighted above with regard to local control it is our view that for a potential 0.8% increase in returns (about £200m per annum in cash terms) coupled with an estimated £34m in savings the option should be explored further.

In seeking to make the case for a single London fund we recognise and would support the concept that its administering authority be a new functional body based on the bedrock of local accountability via the direction of elected members of the constituent boroughs into which the LPFA would be absorbed.



## Section 8: Implementation (Recommendations 25, 26 and 27)

**Recommendation:** The **consultation process itself should be centrally co-ordinated**: to set the cost ceilings and timetables for consultation and overall implementation. However, the **consultation on details should be conducted scheme by scheme involving employees and their representatives** (Recommendation 25).

**Recommendation:** The Commission's view is that even allowing for the necessary processes it should be possible to **introduce the new schemes before the end of this Parliament** and we would encourage the Government to aim for implementation within this timeframe (Recommendation 26).

**Recommendation:** There will **need to be the right resource**, on top of business as usual, to drive the reforms; particularly given the challenging timescale and scope of the reforms (Recommendation 27b).

**Recommendation:** **Best practice governance arrangements** should be followed for **both business as usual and the transformation process**, for each scheme (Recommendation 27a).

### LPFA Response

#### 8.1 Implementation

Our response on implementation is twofold. Firstly to reiterate our belief that implementation in the timescale is only realistic if it does not have to follow primary legislation. Secondly it is a plea that the regulations when finally formatted take into account the requirements and therefore cost of administering them.

This is not to appeal for practitioner driven regulations rather that the views of practitioners are listened to prior to the drafting process. The aim would be to make the provisions of the scheme simpler and therefore cheaper to administer.

A major element of complexity and cost is gathering data from employers. The main reason being that payroll teams and systems are set up to turn gross pay in net pay on a weekly/monthly basis not capture the data needed for pensions.

If when designing the new scheme ways could be found to match payroll practice so that pension data could be a result of or piggybacked from existing processes then real savings could be made by both parties.

LPFA are happy to assist DCLG officials in any way we can during the pre implementation period. In particular we would offer to draft a more detailed paper on the legal and practical options available to implement a new scheme using the principles set on in recommendations 26, 27b and 27a above.