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Late Retirement Factors : Update for Cost Management Committee

1. I said I would provide you with an update on the progress we have made on the development of a new approach to Late Retirement Factors (LRFs), following the Minister's request that the SAB provide recommendations for improvements.
2. I intend to provide the Committee with a draft revised guidance note in the next few weeks as part of a short, technical consultation on the content. I can also provide the committee with this indication of the recommendations that we will be making to our Minister about how the new process is intended to work. I can also undertake that the views of the committee, and consultees, will be shared with the Minister in making his final decision after the consultation period.

Key features of the new approach

3. As you are aware, the key and shared objective was to remove the "cliff edge" when factors change. When the factors changed last, in January 2017, there was a significant and immediate reduction in the uplift that became payable to those who had worked past pension age. This seemed to be unfair and so we agreed to move to an approach more consistent with the scheme's current CARE design.
4. Under the new approach the period worked past normal retirement age is divided into the periods prior and post the introduction of the new factors. The increase for the former is calculated on the current factors and method, and that for the latter on the new factors. This results in a smoother transition between one set of factors and the next for individual members.
5. This methodology will be set out in the revised guidance note that will be sent for circulation. That note will also include some worked examples to help administrators follow the new approach. GAD will also provide some illustrations to show how the cliff edge is removed and we will include these with the consultation.

Other policy choices

6. During the course of our discussions, representations were made from member representatives that the use of long term pay assumptions in calculation of LRFs was not appropriate. This was both on the basis that the longer term assumption was more positive, as it assumed an end to the ongoing policy of pay restraint, and also because it was asserted that periods of service after pension age tended to be short and it was unlikely that those staying on would

receive further significant increases in pay (which are part of the longer term assumption for the workforce as a whole).

7. On the data point, we were not able to obtain relevant data from the valuation that would confirm the assumptions made by the unions. We also note that there is no official short-term salary growth assumption that could easily be plugged into the GAD factor review. Such an assumption would, by its nature, have a short shelf life meaning that it, and the factors derived from it, would need frequent re-calculating. That would run counter to our main policy intent, which is to provide greater certainty to members.
8. More fundamentally, change in the LRF is driven by the difference between the salary growth assumption and the SCAPE rate (which is itself based on the long term forecast of GDP growth). It is likely that these two indicators will move largely in tandem, and so we do not believe that there will be much to be gained by members through moving to short-term forecasts for both of these indices, other than creating more uncertainty and greater administrative costs.

Implementing the new approach and factors

9. The new approach will apply to all retirements from the date at which the new factors and guidance is issued. We do not intend to recommend that this methodology be backdated to an earlier date. Although affected members' benefits would be increased if the approach were backdated to include service before the change in January 2017, there is no obvious date to choose and no value for money case for funds to offer what would be a gratuitous benefit for members who had already retired.

Conclusion

10. I am also including with the covering email a note from GAD which illustrates the proposed approach and I would be very happy to discuss this and take questions from Committee members at their meeting on 5 February.

Jeremy Hughes