

Advisory Board

Agenda item 7 – Paper F - Deficit management in the LGPS - recommendations for regulation changes

Background

The shadow Scheme Advisory Board (SSAB) commenced its deficit management project in summer 2014 following a request from the then Minister for Local Government, Brandon Lewis, that the Board make innovative proposals on this topic. At its December 2014 meeting, the SSAB agreed a comprehensive work plan with the aim of improving the management of Scheme deficits on a lasting basis using best practice from across the pensions landscape.

The work plan set out certain matters upon which changes to Scheme regulations may be desirable. The potential amendments in each of those areas were considered first by a SSAB deficits working group on 19th March 2015 and then by the full SSAB on 23rd March 2015. This paper is now submitted to the Department to outline the recommendations the SSAB wishes to make.

Recommendations

Standardised funding calculations

The SSAB believes that the calculation of a measure of funding on a standardised basis is a crucial aspect of improving deficit management on a lasting basis. This will provide a means for comparison from one fund to another and allow for a consistent means via which changes in the funding of the Scheme may be viewed over time..

Recommendation 1 - A requirement for fund actuaries to calculate comparative funding levels on a standardised basis by 30th September in each valuation year should be adopted in regulation.

Recommendation 2 - Scheme regulation should require the Scheme Advisory Board to set and publish assumptions for use in standardised funding calculations along with supporting commentary by 31st March in each valuation year.

Reporting of employer contribution rates

The SSAB believes that the current regulations governing the setting and publication of contribution rates, in particular the notion of a 'common' or 'primary' contribution rate with little meaningful practical usage, are outdated and need a fundamental overhaul to improve the transparency and consistency in the reporting of contribution rates.

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Recommendation 3 - Scheme regulations should require that:

- The actual contribution rate payable for each employer/ pool in an administering authority be published in the valuation report split by future service rate contributions (expressed as a percentage of payroll) and deficit contributions (expressed as a cash sum).
- Where the deficit contributions for an employer/ pool are actually payable on a percentage of payroll basis, the total amount expected to be paid in cash should be used for reporting purposes.
- The fund actuary should continue to have regard to all the matters already outlined in regulation 62(6) of the LGPS Regulations 2013 in setting contribution rates.
- On a fund-wide basis, the individual employer/ pool results should be aggregated and published in the valuation report to give the total future service contribution rate and deficit recovery contributions (expressed in percentage of payroll and cash terms respectively) for that pension fund. This should replace the requirement for publication of the common/ primary contribution rate currently specified in regulation.
- The fund actuary must certify that the above aggregated contributions are in line with the pension fund's published funding strategy (in particular the required investment return) and stated average deficit recovery period for the pension fund.

A minimum employer contribution rate

The setting of a minimum employer contribution has been spoken about in the LGPS for a number of years and could be a useful tool to prevent instances of employers taking contribution holidays, as has sometimes been done in the past.

Recommendation 4 - The setting of a minimum employer contribution rate should be consulted on with a view to mandating for this in regulation. Consultation should be undertaken to a) identify the variety of exclusions that may need to be applied to this requirement, and b) seek views on the appropriate level at which the employer contribution floor should be set. The SSAB's view is that an employer floor set at the average employee contribution rate would be a sensible level to consider in the first instance.

Deficit recovery plan methodology

The SSAB's view is that there should be a clear link between the individual employer contribution rates set at each triennial valuation, length of the deficit recovery period, and the approach set out in each administering authority's funding strategy statement. Each employer should be able to clearly see the basis on which their deficit recovery period and deficit contributions have been set. Whilst it is acknowledged that in many cases this link is clear and there is a transparent approach outlined in funding strategy statements, it is important that this standard is upheld across the Scheme.

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Recommendation 5 - Regulations should require that each administering authority's funding strategy statement sets out the recovery plan methodology adopted and in particular how it has been applied in setting employers' deficit recovery periods and deficit contributions.

Flexibility of employer exits

Additionally, the SSAB notes the recent amendments to regulation 64 of the LGPS Regulations 2013 that have been made to increase the flexibility available to administering authorities in managing employer exits. The SSAB's view is that these flexibilities appear to give administering authorities additional scope to tackle the problems brought about by the 'cliff-edge' employers often found themselves faced with. However there may be room for additional flexibilities (for example the ability to vary deficit contributions between valuations) and will consider the need for further amendments to regulation in this area.

Next steps

The SSAB will shortly be superseded by the statutory Scheme Advisory Board (SAB). The deficits work programme that the SSAB has proposed for the SAB is extensive and would seek to fundamentally overhaul the approach to deficit management used in the LGPS. The SAB will be taking that work forward upon its establishment and confirmation of its funding for 2015/16 upon which much of the work programme depends.

One of the matters included in the SAB work programme is to undertake broader research on deficit management strategies, taking account of differing approaches adopted throughout the world and ascertaining what could be done to make these approaches work for the LGPS. We would appreciate the views of Government on this 'blue sky thinking' exercise as to:

- the objectives that this research would seek to address,
- any limitations that the SAB should consider in determining the topics to research, and
- any other considerations that would help to ensure that the research undertaken is focussed on practical and reasonable proposals.

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