

Shadow Advisory Board

Item 5 - Paper 5a - Deficit management in the LGPS

This document outlines the matters for the Shadow Scheme Advisory Board's (SSAB's) awareness/ consideration under this agenda item:

- 1) to be aware of the issuance of a letter from the SSAB chair to LGPS pension funds re. the deficit management project, including the Board's work plan for tackling this project.
- 2) to consider the content of the draft communications plan for the project,
- 3) to consider the programme for the SSAB event to be held on 24th April, and
- 4) to consider the recommendations made by the sub-committee in respect of the assumptions to be used in the SSAB's consistent funding level calculations.

1) Deficit management letter/ work plan

On 29th January, a letter was issued to those in LGPS pension funds confirming the SSAB's deficit management project and introducing its work plan for taking this project forward. In summary this letter:

- 5) provided an overview of the background to the Board's work following the Ministers' request that this matter be considered further by the SSAB in a letter sent in May 2014,
- 6) outlined how the project commenced, with the establishment of a deficits working group and the commissioning of a specialist piece of work from PwC,
- 7) detailed the main findings of the PwC report, and
- 8) set out the SSAB's work programme for taking this matter forward.

The letter and the work plan issued are appended to this document.

2) Deficit management communications plan

Following the recommendation made at the last meeting that the SSAB seek to engage further with the sector, in particular on the deficit management project, a draft deficit management communications plan is included under this agenda item as **Paper 5b** for the SSAB's consideration.

3) SSAB event 24th April 2015 programme

A SSAB event has been scheduled for 24th April 2015 in order to provide more general information on the work of the Shadow Advisory Board, but with a particular focus on the deficit management project. A draft programme for this event is included under this agenda item as **Paper 5c** for the SSAB's consideration.

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4) Cost Management & Contributions sub-committee assumptions recommendations

The Cost Management & Contributions sub-committee will consider the assumptions which should be adopted for the SSAB's undertaking to produce funding levels for LGPS funds on a comparable basis at its meeting of 5th February 2015, and whether these should be set nationally or locally.

The paper that will be considered by the sub-committee at that meeting is located under this agenda item as **Paper 5d** with section 3 of that paper relating to the calculation of local funding levels on a comparable basis.

The SSAB are asked to consider the sub-committee's recommendations in view of the verbal update provided.

Board Secretariat,
2 February 2015

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29th January 2015

For the attention of LGPS administering authorities in England & Wales

Dear colleague,

You may be aware that in recent months the Shadow Scheme Advisory Board (the SSAB) has commenced a project to consider how deficits can be managed better at both fund and employer level in the Local Government Pension Scheme in England & Wales. This project aims to ensure that a stronger, more flexible approach to deficit management can be adopted across the LGPS. I am writing to set out some background to this project and to outline our work plan for developing this project in 2015.

Background

In its evidence last January to the Government's Call for Evidence on structural reform, the SSAB set out the case for a high level consideration of the management of deficits in the LGPS. The SSAB was clear that any reforms to investment structures which did not take account of fund deficits would ultimately be ineffective.

As a result of the Board's recommendation, the then Minister for Local Government, Brandon Lewis, asked the SSAB to bring forward proposals for the management of deficits in the LGPS.

In June 2014, in response to the Minister's request, the SSAB set up a Deficits Working Group, reporting to the SSAB, and comprising a range of the stakeholders represented on the SSAB and its sub-committees to take forward this important workstream. In July 2014 a specialist piece of work was commissioned from PwC to provide detailed analysis to support the development of policy recommendations. This report makes several suggestions such as:

- That the disclosure of funding levels calculated on a comparable basis using standardised assumptions would provide a clear overall picture of the deficit across the Scheme and provide a platform from which better deficit management in the LGPS could be pursued.
- That efforts should be made to promote the use of both covenant checks and available security arrangements where these are appropriate in order that

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funds are best protected from the risk of employers becoming insolvent or becoming unable to meet their obligations.

- That guidance should be given to promote the early targeting of cessation deficits in the run up to employer exits. Changes in regulations to allow more flexible exit arrangements to be undertaken should also be considered.
- That disclosure of funding levels calculated on a consistent basis would allow for more reliable comparison of funds, which could be undertaken using a range of financial and governance metrics. This would aid the process of identifying where help and intervention may be needed.
- That the development of guidance on other matters such as the setting of deficit recovery periods, the requirement for stability in employer contribution rates and the use of employer contribution floors should also be considered.

This report, and the further work of the Deficits Working Group, form the basis of the work plan that the SSAB has now adopted to develop recommendations for the better management of deficits across the LGPS. We will provide regular progress reports as our work develops. Importantly, this project has sought and is seeking to address deficit management rather than deficit reduction. This distinction is drawn as deficits can only be reduced by improving investment returns and/or increasing employer contribution payments. Deficit reduction is therefore already a focus of pension funds, and LGPS administering authorities will already have powers available under Scheme regulations in order that deficit reduction can be adequately planned for.

Deficits work plan

Having undertaken this preparatory work in 2014, the SSAB has now developed and agreed (at its meeting in December 2014) a deficit management work plan for 2015. I am pleased to share this work programme, attached to this letter, with you.

As you will see, the work programme includes consideration of the following:

- The calculation of comparative funding levels on a to-be-agreed, standardised basis in order that there is a clear picture of the deficits across the Scheme. *[Note - this additional calculation is not intended to replace local funding valuations, which will continue to be calculated on locally agreed bases used to determine employer contribution rates],*
- Changes to regulations to be recommended to DCLG in respect of a variety of matters including that enhanced flexibility is made available to funds in managing employer exit payments.
- The development of best practice guidance for funds in managing their employer deficits, including consideration as to the benefits of covenant checks and of the range of security options available to funds.

The SSAB will be superseded by the statutory Scheme Advisory Board later this year. However, we believe that this project is imperative for the LGPS and hope that

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the work plan provides a clear outline of the work that will need to be undertaken by the statutory Board in its initial months of operation.

Next steps

The detailed timescales for this project are outlined in the work plan. However, there is a need for momentum in tackling a project with so many varying aspects and we hope to make our recommendations about the Scheme changes that will benefit funds and employers by the end of March. For employers, our recommendations will seek to ensure that the regulations are sufficiently flexible to ensure that deficits do not have an undue impact on business decision making. For funds, our recommendations will seek to ensure that funds have the flexibility and breadth of options available so that that they, employers and local taxpayers are best protected from the possible negative effects of deficits.

As ever, the SSAB welcomes the input from the LGPS community in undertaking its work, and this is particularly so with a project of such significance. Please contact the SSAB Secretariat at jeff.houston@local.gov.uk if you would like to contribute any ideas in respect of this project or find out more.

Finally, whilst deficit management is an important issue for the Scheme, the SSAB feels strongly that the LGPS is in a broadly positive position. As the UK's only major funded public service pension scheme, the LGPS has a robust asset reserve which, in England & Wales, totals over £180 billion pounds. Our project is focussed on taking a comprehensive approach to the deficits that exist in the Scheme in order that individual pension funds, and the LGPS more generally, are best placed to pro-actively manage these in the years to come.

For updates on the project as work continues, please look at the updates provided in the Board Updates section of www.lgpsboard.org.

Yours faithfully,



Joanne Segars

Chair, Shadow Scheme Advisory Board

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2015 deficit management project - work plan

No.	Work to be undertaken	Timescales
1.	To consult with the LGPS community on revisions to the calculation of exit payments and greater flexibility on recovery of exit payments.	By end of February 2015
2.	To agree the extent to which calculation of comparative funding levels should allow for locally determined assumptions.	By end of February 2015
3.	To recommend the following Scheme changes to DCLG: <ul style="list-style-type: none"> • That a requirement for actuaries to calculate comparative funding levels on a standardised basis by 30th September in each valuation year is adopted, • That the statutory Scheme Advisory Board must set assumptions for standard funding valuations by a given date, • That the stability requirement in respect of primary, secondary and common employer contributions is clarified and is appropriately set. That a minimum employer contribution rate is set, • That funds are required to publish the recovery plan methodology in their funding strategy statements, and • That regulations explicitly allow for pre-funding of employer exit payments. 	By end of March 2015
4.	To commission the re-calculation of the individual 2013 fund valuation results on an agreed standardised basis. Figures to be included in the 2014/15 scheme annual report.	From April 2015 (following establishment of statutory Scheme Advisory Board) in time for the publication of the 2014/15 annual report.
5.	To research further the possibility of mandating that deficit contributions are paid in cash terms, rather than pensionable pay terms. Consequential recommendation to be made to DCLG if necessary.	From April 2015 (following establishment of statutory Scheme Advisory Board)
6.	To commission data gathering in respect of impacts of : <ol style="list-style-type: none"> a) changes in asset allocation, and b) manager churn 	From April 2015 (following establishment of statutory Scheme Advisory Board)

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	on fund investment performance	
7.	To commission and develop best practice guidance for funds on employer management (including consideration of covenant checks, matters to consider on entering into admission agreements, security, etc)	From April 2015 (following establishment of statutory Scheme Advisory Board)
8.	To commission and develop recommendations for where intervention may be necessary in order to improve deficit management and/ or related governance processes.	From April 2015 (following establishment of statutory Scheme Advisory Board)
9.	To commission and develop guidance for funds in using liability matching investment strategies including liability driven investment.	From April 2015 (following establishment of statutory Scheme Advisory Board)
10.	To commission further research on broader strategies such as fixed liability funds and other alternatives.	From April 2015 (following establishment of statutory Scheme Advisory Board)

29th January 2015