

Shadow Advisory Board

The cost control process in the LGPS - Briefing note for members and employers

1. Background

A new legal framework under which public service pensions must operate was implemented via the Public Service Pensions Act 2013. A fundamental aim of the reforms made through that Act was to design public service pension schemes which had the principles of sustainability and affordability at their heart.

To achieve this, a crucial part of the new public service pension scheme framework is the requirement for schemes' costs to be periodically assessed against a cost control mechanism. In the LGPS in England & Wales, there will be two cost control mechanisms:

- a) the employer cost cap (ECC) process as operated by HM Treasury (HMT), and
- b) the future service cost (FSC) process as operated by the LGPS Scheme Advisory Board to the satisfaction of the Department for Communities and Local Government (DCLG)

Both processes could lead to changes to the scheme design or to the level of members' contributions if the mechanisms demonstrate that the cost of the LGPS has moved sufficiently from the target.

2. The two mechanisms

There are two mechanisms because the ECC process has been partly established in order to demonstrate consistency between the public service pension schemes. In consequence, it was felt that it would be important that a process be established which is more tailored to LGPS experience and the FSC process has been designed to do that.

There will be a number of differences between the two processes, which will mean that the figures calculated through the ECC process won't always match the figures calculated through the FSC process.

In the event that the ECC is triggered but the FSC isn't, the ECC mechanism as operated by HM Treasury will take precedence.

3. The target costs

The target cost for the FSC process is 19.5% as a total of employer and member contributions at a 2:1 ratio (13% relating to employers' contributions and 6.5%

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relating to members'). The target cost for the ECC process is X% of employer contributions alone.

Comment [CH1]: To be confirmed

There are some differences between the mechanisms in how the requirement to make changes to the Scheme is triggered, but under either process, movement of 2% or more from the target in either direction must require changes to be made to bring the Scheme cost back to the target.

The mechanisms are both only concerned with calculating the cost of providing benefits that have been accrued since the career average reforms took effect in April 2014. The total employer contributions targeted of 13% for the FSC and X% for the ECC are therefore notional figures, and most employers will find they pay contributions that are different to these notional rates (for a number of reasons, as outlined further below).

Comment [CH2]: To be confirmed

4. The cost control mechanisms and local funding valuations

Whilst local funding valuations and the cost control processes will be undertaken in parallel every three years from 2016, there are significant differences in the purposes of these and the processes through which these are undertaken.

Local funding valuations include consideration of all benefits promises made by the Scheme in each fund, whereas the cost control processes will only be looking at the elements arising from the post-April 2014 career average benefits structure.

In addition, the calculations of local funding valuations and the assumptions as to future experience will be specific to each fund and to each employer, whereas the cost control processes will be looking at the membership across the LGPS, and will similarly be making assumptions at a Scheme-wide level.

For these reasons, the contribution rates of individual employers are not comparable with the results that will emerge from either of the cost control processes.

5. The possible impacts on members and employers of the cost control processes

The cost control processes have been implemented as a means of reviewing the sustainability and affordability of the career average structure of the LGPS.

Members should be aware that increases or decreases in the costs of the Scheme which are sufficient to trigger either of the mechanisms may result in changes to either the design of members' benefits, or to members' contributions rates, to bring the Scheme back to the target.

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Whilst the levers to reform the Scheme on either the ECC or FSC being triggered are levers that would effect member benefits or member contributions, employers should be aware of the need to communicate with their members to ensure that they understand any changes arising from either of the cost control mechanisms.

Employer administration practices may also need to be adapted in the event of reforms making changes to the scheme's member contribution rates or benefits structure.

6. Find out more

To find out more about the cost control mechanisms and how they relate to the LGPS, please see our [extended briefing note](#).

Comment [CH3]: To add link when finalised.

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