



Independent Public Service Pensions Commission

Responses to the call for evidence for Lord Hutton's final report on how public service pensions can be made sustainable and affordable in the long term, fair to both the public service workforce and the taxpayer, and ensure they are consistent with the fiscal challenges ahead, while protecting existing accrued pension rights.

SUBMISSION BY
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Scheme Design

Q1) What is an appropriate scheme design for public service pensions? Why?

The LGPS is different in many aspects when compared with the other public sector schemes, not least in its composition of employers and employees; it has a strong positive cash flow and significant funds set aside to meet future liabilities. The NAPF has recently detailed some of these differences – see attached. The LGPS should have a scheme that meets its circumstances built on its strengths. As such, a revised LGPS with an appropriate scheme design should have the following characteristics:

- i) Defined benefit.
- ii) Career average revalued earnings (CARE).
- iii) Normal retirement age that rises in line with state retirement age.
- iv) A cap should be set on the long-term employer rate at a national level, and any need for long-term additional funding should come from employee contributions or changes in accrual rates which cannot be offset by additional investment income.
- v) Previous accrual rights should be protected based upon a final salary at the date of change to the new scheme uplifted by CPI.
- vi) Tiered employee contributions according to salary level.
- vii) Flexible retirement options for the employee at employer discretion and at no cost to the employer.
- viii) Facility for additional saving at no cost or risk to the employer.
- ix) Local discretions for employees and employers to suit local circumstances, eg, limits on salary level eligibility.

The above proposals reflect the changes recently already made, eg, move to CPI from RPI and rise in retirement age. These have assisted greatly in ensuring the LGPS is affordable, fair and sustainable.

The proportion of high earners in the LGPS is very small, and applying a cap on eligibility to the scheme through a set salary level has no material impact on costs of the scheme. The issue of how high pay individuals are treated for pension purposes is addressed through having CARE facilities, tiered contribution rates and the tax system with its recent changes. There is no case for excluding any local government employee. However, it may assist some employers and employees to be able to exercise local discretions over salary levels at which contributing membership ceases. The new scheme proposed can address issues of fairness and affordability for higher earners.

In respect of the LGPS scheme outlined above, it would rank highly in terms of meeting the criterion established in the interim report for considering any new scheme options.

A demonstration of how the scheme proposed above could meet the criteria put forward in the interim Commission report is highlighted below. It is emphasised that these proposals only relate to the LGPS. The LGPS is funded and needs to have its own shape and scope to meet its local implementation and specific occupational pension/pay and workforce requirements.

AFFORDABILITY	Action had been taken over recent years to keep the LGPS affordable. Recent Government changes will add to this direction of travel, and the move proposed to a career average with a 'cap' arrangement on employers' costs will make it affordable to employees and taxpayers. The funded nature of the LGPS and local democratic control enables it to effectively manage the short- to medium-term volatility in pension costs.
SUSTAINABILITY	The funded nature of the LGPS, the strong cash flow and regular robust triennial valuation provides a strong base for continuing sustainability. The ability to adjust retirement age, scheme benefits and employer contributions over the medium- to long-term will ensure future sustainability for employers and their funders, while offering a quality pension scheme to employees.
ADEQUACY	A career average DB based scheme would deliver an adequate pension scheme for the very diverse range of LGPS members.
FAIRNESS	The proposed career average DB scheme with tiered contribution rates is fair between scheme members. The scheme proposed should be comparable with the typical private sector DB scheme without being over generous in providing an adequate pension and allowing pensioners a high level of financial independency.
SUPPORTING PRODUCTIVITY	The proposed scheme should be attractive to the workforce as part of any national or local package of measures for recruitment and retention of the wide range of skilled staff needed to deliver local government services. The arrangements should also provide a mechanism that allows the free movement of employees between providers, including the private sector, without creating barriers of cost or administration (see also Q18).
TRANSPARENCY OR CLARITY	The costs of the LGPS are highly visible and transparent to all stakeholders through the publication of detailed annual reports, triennial valuations, local pension committees and publication of policies and procedures.
SIMPLICITY	The proposed career average DB scheme is strong on being relatively simple for all interested parties to understand and administer. The changes required could be done quickly and at much lower cost than more complex mixed design schemes that could be considered.

Introducing alternative hybrid or combined DB and DC schemes introduces significant complexity, costs, delays implementation and does not add significantly to the level at which the LGPS meets the criterion established for evaluating future options referred to above.

Risk Sharing

Q2) Which risks associated with pension saving should the scheme members bear, which by the employer and which should be shared? Why?

The risks for the LGPS are as follows:

- i) **INVESTMENT RISK**
 - current funds held
 - funds from future contributions
- ii) **DEMOGRAPHIC TYPE RISKS**
 - longevity
 - ill-health
 - dependants
- iii) **INFLATION**
 - pay levels
 - pension increases

The changes already made (eg, move from RPI to CPI and rise in retirement age) will reduce the risk of additional funding demands on employers. In addition, the proposals in response to Q1 will further reduce the risks (e.g. CARE, employer contributions capped, retirement age linked to state retirement age). Any risks in the new proposed scheme are for the employer until the cap is reached which will manage affordability and sustainability issues. Risks from whatever source that lead to costs exceeding the 'cap' are for the employee to fund over the medium- to long-term.

Q3) What mechanisms could be used to help control costs in public service schemes? For example, is there merit in flexible normal pension ages linked to changes in longevity? What indexation factor should be used in a career average type scheme to ensure a reasonable balance of risk between scheme members and taxpayers?

The response to Q1 and Q2 contain the mechanisms for controlling costs, eg, use of CPI, link to future state retirement age, and ultimate control of an employer cap on contributions through adjusting accrual rates and/or employee contributions.

Q4) Where and how have risks associated with pensions been effectively shared in private sector companies?

In private sector DB schemes, the issues are very similar. The private sector has moved more quickly in addressing the affordability issues for the employer, and depending upon the local circumstances sought to reduce these risks. Public sector organisations are in a position to take a much longer term view on managing the risks, and have an ability to manage short- to medium-term volatility. DC schemes already pass the risks to the employee and present major problems in funding adequate pensions in retirement.

Q5) Which international examples of good practice in the area of risk sharing should the Commission consider when compiling the final report? Why?

No comment.

Q6) What should the split between member and employer contributions look like?

A detailed response requires work by an actuary, but for the LGPS, the bulk of the membership is on relatively low pay levels and to avoid discouraging savings, employee contribution rates need to be around 5%, rising as pay levels rise, to something of the order of 10%. The employer paying the balance to deliver the scheme outlined at Q1 leading to future rates of say 10% to 12%. These are broad indications requiring detailed negotiations between Government, trade unions and employer representatives.

From the employer standpoint, the key consideration is the total cost of remuneration, which represents the salary, employer contributions and any other job related benefits provided. How much of the total remuneration package should be paid by way of employer contributions is not something for which there is a logical or obvious right answer.

If a cap is placed on employer contributions, then the employee contributions (or scheme benefits) would in any case be expected to change over time in response to changes in the cost of the scheme. There is also no necessary reason why the respective shares of the scheme cost that are met by the employee and employer should be the same across the various public sector schemes. They are, at present, in fact very different.

The current levels of employee contributions to the LGPS, along with the current level of scheme benefits, have been arrived at in the course of collective bargaining between unions and employers about the overall remuneration arrangements. There is no basis to argue that there should be a radical move away from the current proportions, in order to arrive at some theoretically 'right' levels of employee and employer contributions.

Q7) Should there be different treatment of different professions (for example, lower normal pension ages for some public service employees)?

No comments on other public sector schemes, but in respect of LGPS all eligible employees should be treated the same. The issues of how employees cope with working longer when mental and physical demands on some individuals may become challenging, can be addressed through ill-health arrangements and flexible retirement options; in particular, by allowing early retirement on actuarial reduced benefits so there are no additional pension costs to the employer.

Q8) Should there be different treatment for those at different income levels?

In terms of the LGPS, the current tiered contributions should be maintained at broadly the current levels for the reasons set out earlier with the introduction of a lower band for the lowest paid, offset by a higher band for the higher paid. There should be discretion for the employees to opt out part of their salary as pensionable pay. Employers at a local level should have the option to negotiate local pensionable pay limits for the higher paid above a set limit (say £140,000 or Prime Minister's pay level).

Q9) What is the appropriate normal pension age for the different public service schemes? Should this vary across schemes and, if so, why?

Normal pension retirement age should be linked to state pension retirement age.

Adequacy

Q10) How should the Commission think about measuring adequate levels of resources in retirement?

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Q11) What should be considered an adequate level of resources in retirement?

Measuring levels of adequacy are complex: elements are subjective and the circumstances of individuals very wide-ranging making comparisons difficult. The Turner Commission and PPI (Pensions Policy Institute) studies have used replacement ratios calculated on an individual's post-retirement income as a proportion of pre-retirement income and produce a simple relative measure. This approach is supported.

A further measure reflecting many low pay individuals are in the public sector schemes, particularly the LGPS, should be to ensure the level of pension received is sufficient to lift the individual out of the need for them to claim state benefits in retirement. The pension achievable should be at a level to encourage individuals to save – saving should be rewarded.

Q12) Should a full state pension and a full public service pension ensure people have adequate resources in retirement? Or should room be left for individuals to make their own arrangements?

The LGPS pension, for someone contributing over a significant proportion of their working life, should provide an adequate pension without the need for further additions except for their state pension.

Q13) How should this change where people work part-careers in public service?

The objectives set in response to Q11 and Q12 should be achievable for part-timers and those with breaks in service as is the case currently for the average low paid LGPS member provided they have a 'significant' period of membership. 'Significant' being based upon current position in LGPS for such employees. Individuals with higher levels of pay should receive an appropriate pension proportion to their full time equivalent, as provided for under existing arrangements.

Employee Understanding and Choice

Q14) How much do workers value and understand pensions? Is there any evidence this differs between groups (for example, by age, by income)?

The majority of LGPS members have some understanding of pensions. The knowledge and understanding increases as employees approach retirement or their continued employment is threatened or subject to change.

The evidence for this is the workshops, seminars and queries the Fund receives from its members. The level of income or gender of the individual does not appear to affect this maturing interest. The lack of apparent interest in pensions from employees in their early years, needs to be seen in the context that is generally accepted that their pension requirements are being 'looked after' adequately because they work in the public sector.

Q15) Which forms of scheme design will encourage employees to save for their retirement? Is there any evidence from pension scheme reforms influencing opt out rates in the private sector?

The features of a pension scheme that are likely to encourage individuals to save are:

- view of their colleagues including perceived affordability.
- the information they are given about pensions.
- the reputation of the scheme and the trust and confidence demonstrated (that the pension promise will be delivered)
- simple to understand with certain pension outcomes
- financially attractive in terms of contributions, tax relief and level of benefits
- trade union position on scheme offered

These are features of the current LGPS DB scheme and proposed scheme at Q1.

Q16) What best practice exists in the private sector around communication of benefits with scheme members?

Some LGPS funds and a number of private sector schemes have demonstrated good practice and have learnt from each other. Many compete each year at the sponsored pensions awards, some of which cover communications. LGPS funds produce detailed communication strategies.

Q17) Should any new scheme design offer members a degree of choice in the level of contributions paid and benefits received? For example, should members be able to receive a higher pension if they want to take the pension later? Why?

The changing nature of employment and the range of working patterns indicate that it is in the employers' and employees' interests to have some flexibility in terms of taking a pension early with a reduction, working longer and increasing the pension paid. There should also be the facility for the individual to save more to meet their expected retirement needs or objectives such as greater pension or retirement early.

Pensions and plurality of provision of public services

Q18) Whether and how public service pensions could be structured to support a more level playing field between the public and private sectors when tendering for contracts?

Submissions to the Interim Review have suggested that the requirement under Fair Deal for private sector contractors and other non-public bodies to provide 'broadly comparable' pension arrangements for public sector employees who transfer under TUPE arrangements can act as a deterrent to the outsourcing of public services. However, the options around treatment of contractors on admission to the LGPS, that have been developed in recent years, mean that this is now much less of a problem for contractors than it may have been in the past.

Where staff transfer from local government to private sector employment under TUPE arrangements, the new employer will usually become an admitted body within the LGPS (rather than obtaining a broadly comparable pension scheme from a third party pension provider). The mechanism for managing the risks to the employer associated with membership of the LGPS can include measures such as 'cap and collar' arrangements, which limit the extent to which the employer contribution rate can vary over the course of the contract, with the residual risk being retained by the former (public sector) employer.

Q19) Which non-public service employees should be eligible for membership of public service schemes?

A large number of community admission bodies, which include voluntary groups, have been accepted as admission bodies to the LGPS. These bodies typically have a small number of employees and generally low levels of reserves and financial resilience. Some are guaranteed by a parent council for pension liabilities. There is some doubt about whether such bodies should be eligible for participation in the LGPS as stand-alone employers, because of their inability to manage the potential investment and benefit (eg, ill-health) risks that participation in a funded scheme involves. Increasingly, such employers are recognising this and are, themselves, closing their schemes to participation by new (and sometime existing) employees.

Although there is a large number of individual employers who fall into this category, the total number of employees that they represent is very small, around 2% of total scheme membership within the LGPS funds, so their exclusion from eligibility to participate in the LGPS in future would reduce the scheme's coverage of public service employment only vary slightly and may be a disincentive to developing services to local communities and co-ops.

Q20) What evidence is there on administrative costs (excluding fund management costs) of private sector pension schemes? How do these compare with those in the public service schemes?

No comment.

Q21) How do private sector schemes ensure that there is good quality and efficient scheme administration? Which measures can be applied to public service schemes?

No comment.

Q22) Is there scope for rationalising the number of local government pension funds? If so, how could this be achieved?

No comment.

Q23) How can the Commission ensure an effective transition to the new arrangements?

No comment.

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The challenges involved will depend upon the extent of the change. The proposal in response to Q1 would minimise the amount of change and therefore the time needed to introduce the changes and the cost of implementing the changes will be much reduced. If the changes are much greater there will need to be at least a three years' implementation period and significant costs incurred on project management, communication, training, IT software development, consultation on detailed implementation regulations.

The overall scheme could become very complex with a new scheme added to the accrued rights schemes if the methodology of the new scheme is significantly different.

Q24) What can the Commission learn about moving to a new scheme from best practice in the private sector and internationally?

No comment.

Q25) How have accrued rights been protected or transferred during changes in schemes in the private sector?

No comment.

LGPS Mythbusters: A Statistical Summary

Introduction

Lord Hutton's final call for evidence has provided Local Authority funds and the NAPF with an opportunity to dispel some of the myths around the LGPS and to highlight the differences between the LGPS and other public sector schemes. We have set out below a series of useful facts and figures about the LGPS and comparable private sector schemes. We hope this will help you draft your response to Lord Hutton, which is due on the 17th December 2010.

	LGPS	Private Sector DB	NHS ¹	Teachers ²
Avg. employer contributions	19.0%	15.5%	15.4%	14.1%
Avg. employee contributions	6.4%	5.4%	6.5%	6.5%
Avg. pension in payment	£4,150	£7,386	£6,500 ³	£9,900

The LGPS

- There were nearly **1.7m employees in the LGPS**; 1.1m pensioners and 1.2m deferred members at the end of March 2010.⁴
- According to the NAPF Annual Survey 2009, the **average annual pension paid out by the LGPS was £4,150** in 2009.
- The average ongoing **employer contribution to the LGPS was 15.5% in 2009**, with the average total **employer contribution at 18.5%**.⁵
- The average **member contribution to the LGPS was 6.4%**.⁶
- Employee contributions increased by 3% in 2009-10 to £2bn.
- Employers' contributions rose by 7% in 2009-10 to £5.8bn.
- The average funding level for the typical LGPS fund is 69% as of 31 May 2010.⁷

¹ NHS Pensions Statistical summary 2009-10

http://www.nhsbsa.nhs.uk/Documents/NHSBSACorporatePoliciesandProcedures/Pension_Scheme_Accounts_fi nal_160710.pdf

² Teachers' Pension Scheme Statistical Summary 2009-10 <http://www.official-documents.gov.uk/document/hc1011/hc02/0257/0257.pdf>

³ Estimated at last valuation. Current accounts suggest average pension is around £7,000.

⁴ CLG Statistical Release, Local Government Pension Scheme Funds England 2009-10, 13 October 2010.

⁵ Unite the Union,

http://www.unitetheunion.org/news_events/latest_news/ten_top_facts_on_local_govnm.aspx.

⁶ NAPF Annual Survey 2009.

⁷ Hymans Robertson Navigator, "LGPS funding update as at 31 May 2010."

<http://www.hymans.co.uk/PublicSector/Exclusive/Documents/100531%20Navigator%20Results%20paper.pdf>

- In 2009-10, LGPS **expenditure on benefits was £6.3bn** -- an increase of 13% on the £5.6bn in 2008-2009.⁸
- But total **income from contributions and investments was £11.1 billion**, indicating a positive cash flow.
- The **market value of the entire LGPS was £132bn** at the end of March 2010.
- The biggest operating costs for LGPS funds in 2009 was fund management and custody, with an average cost of almost £5m; the average cost for administration, record keeping, communications and collection of contributions stood at £1.8m.

Private sector Schemes (Figures taken from NAPF Annual Survey 2009)

- The **average pension paid out by private sector DB schemes was £7,386** in 2009-10. (The average DC pot was £1,835).
- Private sector **employers contributed on average 19.0%** to their DB pensions.
- **Employees in the private sector on average contributed 5.4%**.
- Average **funding levels of private sector DB schemes was 95%** in 2009 (FRS17).

LGPS v. Other Public Sector Schemes

- The value of a local government pension remained at 20% of salary in 2008.
- The NHS pension was worth around 22% of salary before the 2008 reforms, and for new members this has now been reduced to around 19% of salary.
- The 2007 reform of the teachers' scheme reduced the average value of a pension from 22% to 19% of salary for new members.
- For a new joiner the Civil Service pension is now worth 21% of salary – compared to 28% of salary before 2007.

Other helpful statistics

Employees' perception of pensions (NAPF Workplace Pensions Survey)⁹:

- Overall, 44% of employees considered pensions the best way to save for retirement, up from 35% in 2009 (other options included property, ISAs and bank accounts).
- 51% of men thought that pensions were the best way to save for retirement, compared to 34% of women;
- Overall, 41% of employees saw a pension as the most important additional benefit on top of their basic salary, up from 31% in 2009 (other options included flexible working, bonus, generous holiday allowance, health / life insurance and gym membership).
- 47% of men saw in a pension the most important additional benefit, compared to 32% of women; 52% of those aged 55-64 felt a pension was the most important additional benefit, compared to 21% of those aged 18-24.

If you would like to be in touch with the NAPF policy team regarding your response, please contact Catherine Cunningham on 0207 601 1723 or via email on Catherine.cunningham@napf.co.uk.

⁸ CLG statistical release.

⁹ For the NAPF press release, see go to the [NAPF website](#).