LGPS and SAB update

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This update will cover

- Deficits – are they real, what are the issues, what can be done
- Separation – is it a problem?
- Pooling of investments – why and how
- Exit payment cap – how does it impact on pensions?

Deficits

- Is there a problem?
- What are the issues?
- Scheme Advisory Board work-plan

- A bit of blue sky thinking.....

What Deficit?

- No one really knows – is it £48b or £27b?
- Whatever it is its nowhere near the unfunded deficit of £1.2t
- It will go away of its own accord when interest rates return to long term norms
- Longevity will fall once the ‘sofa generation’ kicks in

But even if that is true what about......

- The political pressure caused by the cash value and percentage size of the deficit.
- The confusion amongst government and scheme employers brought about by the wide range of funding levels (55% to 105%) across the scheme.
- The differential and inconsistent treatment of scheme employers with regard to deficit recovery.
- The uncertainty of future budgeting caused by wide variation in total contribution rates (15% to 39%) and potential for increases next year.
- The financial impact of deficit contributions on scheme employers especially given the current strain on the funding of those same employers.

The numbers (local authority employers)

- 40% cut in government funding since 2010[1]
- £10 billion of gross savings found in the three years from 2011/12[1]
- Council tax now funds around half of local government spending* (up from 40% in 2010)[2]
- Net service spend down from £115b in 2009-10 to £95b in 2014-15 [2]
- Spending per person down by 23.4% on average [2]
- 53% (and rising) of net service spend goes on adult social care [2]
- A further £13b is to be found from government departments from 2015 to 2019/20
- Local authority reserves rose to approximately £24b however only £4b of is neither ring-fenced nor earmarked [3]
- Total local authority employer contributions in 2014 just under £5b[4] so about 5.25% of net spend (or 10.5% of council tax*)
- Of which around £1.8b goes toward paying off the deficit
- Without the deficit the new scheme would cost local authorities about £2.9b[5] per annum or about 3% of net spend (or 6% of council tax*)

Source [1]LGA [2] IFS * excluding directly funded activities [3] DCLG [4]based on 75% LA membership of LGPS, [5]assumes a total £30b payroll and 75% LA membership

And what about......

- The persistence of deficits as a result of some 'rolling over' from valuation to valuation.
- Total employer rates significantly in excess of the future service rate of the LGPS and the employer rates in other public service schemes.
- The growing number of non LA employers that cannot afford to either stay within or leave the scheme.
- The ‘rush to the door’ of employers using companies to close the scheme
- The placing of the funds inside host authorities subjecting them to local authority financial rules which limit options compared to private sector schemes. We will come back to that later......

SAB work-plan (1)

1. To consult with the LGPS community on revisions to the calculation of exit payments and greater flexibility on recovery of exit payments.

2. To agree the extent to which calculation of comparative funding levels should allow for locally determined assumptions.

3. To recommend the following Scheme changes to DCLG:

- 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.

SAB work-plan (2)

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.

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.

6. To commission data gathering in respect of impacts of :

a) changes in asset allocation, and

b) manager churn

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)

8. To commission and develop recommendations for where intervention may be necessary in order to improve deficit management and/ or related governance processes.

9. To commission and develop guidance for funds in using liability matching investment strategies including liability driven investment.

SAB work-plan progress

Items 1 to 3	1 Complete with amendments made to regulations to allows flexibility 2 Local assumptions agreed and built in standard funding model 3 Complete so far as recommendations have been submitted to DCLG on the matters listed
Item 4	Quote received from GAD for work agreed subject to confirmation of funding
Item 5	Principle of cash payments agreed and will be included in next DCLG consultation
Item 6	Awaiting confirmation of funding
Item 7	Awaiting confirmation of funding
Item 8	KPIs revisions from Board back to Annual Report working group (27th July) then out for consultation with funds. DCLG and GAD to consider how best to match the KPIs to the process of determining Section 13[1] intervention
Item 9	Awaiting confirmation of funding

[1]Section 13 of Public Service Pensions Act allows for the responsible authority under (6)(c)(ii) to direct the scheme manager to take such remedial steps as the responsible authority considers appropriate where the stated aims of subsection (2) solvency and long term cost efficiency have not been met

Blue sky thinking.....a personal view of the options

Work-plan ‘10. To commission further research on broader strategies such as fixed liability funds and other alternatives........’

Change the liabilities: yet more Intergenerational inequality? What about the 25 year promise? Is past service untouchable?

Government to set the deficit: HMT assumptions for local valuations?

Restructure the liabilities: is the number of employers spread across so many funds preventing liability matching? What about pooling employer types in a smaller number of funds? Who is the scheme really for?

Different funding models: local fixed liability (pensioner) funds?, national fixed liability fund?, shift to full PAYG - the Royal Mail option?

Payments of deficits: longer repayment periods? best estimate? managed exist of smaller employers?

Separation – what’s the problem?

- Deficits : what is the pension fund? use of reserves? sale of capital assets? accounting for contributions outside of capped expenditure? Funding the deficit through lending?
- IORP and MiFID: Lack of legal distinction leads to unintended consequences – e.g. retail status for fund investments
- Potential for conflict of interest: in times of austerity should the separately funded pensions service be ‘protected’ and what could be the consequences of not doing so?

Separation – options?

- Enhanced current model : stronger and higher ring fence around fund, clearer delegations, dedicated officer teams
- Joint committee/combined authority: the South Yorkshire model, how would this fit with pooling?
- Move closer to ‘trust’ base: be careful what you wish for!
- SAB have parked this debate while pooling is dealt with

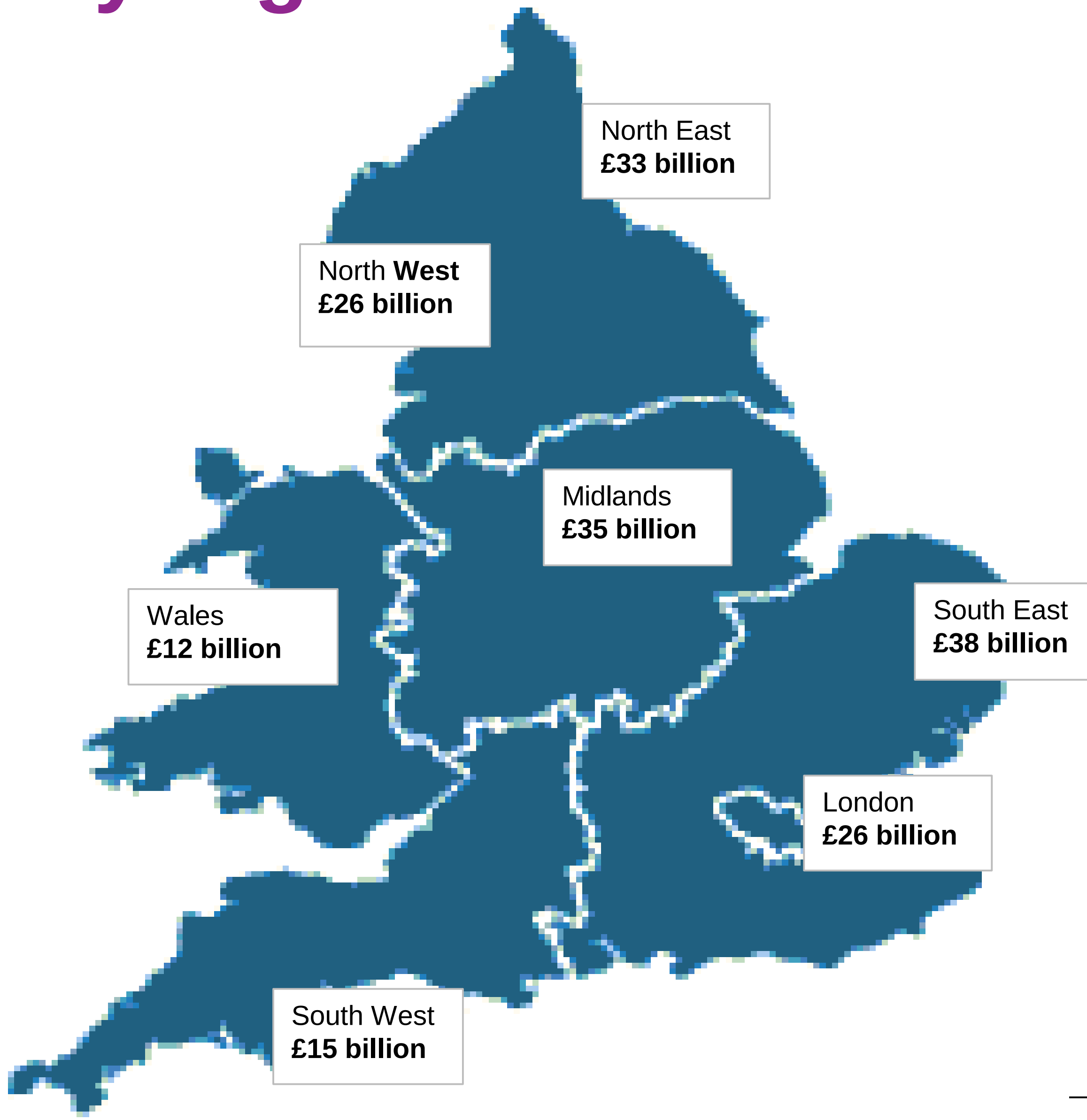
Pooling– overview

- Consultation on criteria is happening <u>now</u> – to be published in autumn
- Criteria likely to be around size (big), cost (no target but significant savings expected), governance and something on infrastructure
- Also in autumn - consultation expected on new investment regs and 'back stop' legislation (will apply if criteria not met by any fund)
- Thoughts about pooling should be underway now with a view to options going to ministers - probably early next year
- Announcement likely in Spring 2016
- Asset allocation to be left at the local level – to what extent?
- Govt alive to transition issues and timing but structures probably expected to be in place in this parliament
- No fixed ideas on structure (CIV, CIF, joint procurement) or type of pools (regional, multi asset or single asset)......

Pooling– arbitrary regional?

South West	£14,607,962
South East	£37,816,063
London	£25,621,998
Midlands	£35,134,218
North West	£26,371,178
North East	£33,376,148
Wales	£11,825,847
Others*	£7,341,740
	£192,095,154

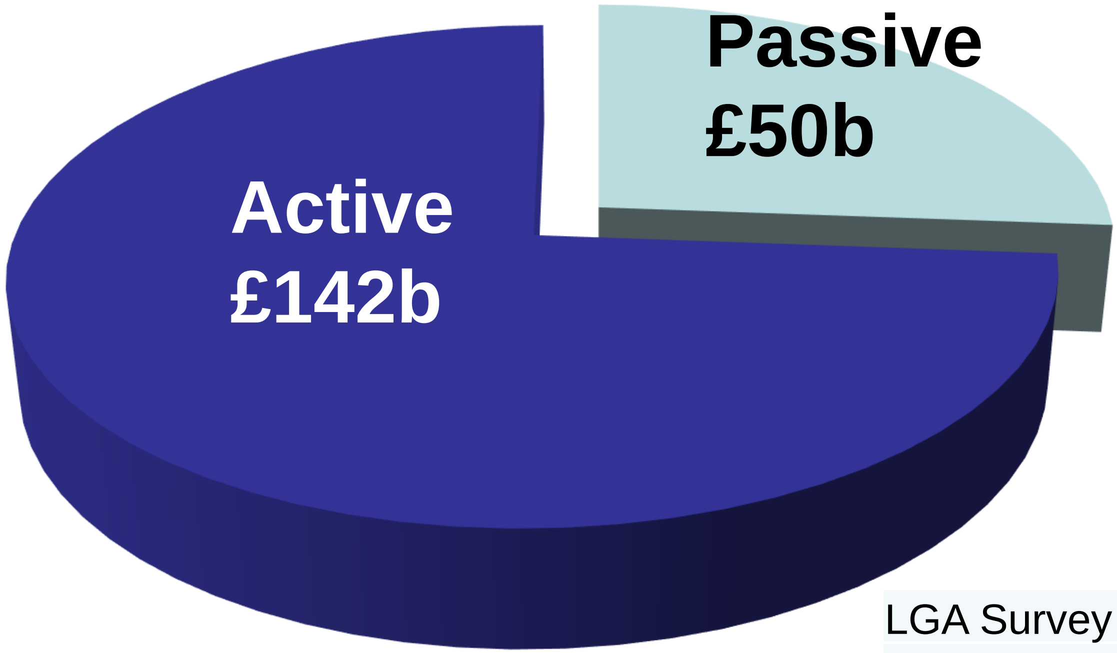
*Environment Agency and LPFA Source Scheme Annual Report 2015



Pooling– asset class?

Asset class	Asset type	£000s	%	£b	%
Fixed interest	UK	7,008,315	3.7%	**£10.7**	5.5%
	Overseas	3,605,677	1.9%		
Index-linked	UK (where stated)	3,947,876	2.1%	**£4.7**	2.4%
	Overseas	676,118	0.4%		
Equities	UK	33,907,389	17.7%	**£73.8**	38.5%
	Overseas	39,832,146	20.8%		
PIVs		78,702,895	41.1%	**£78.9**	41.1%
Property	PIVs	7,834,337	4.1%	**£12.9**	6.6%
	Direct investment	4,881,477	2.6%		
Other		10,936,038	5.7%	**£11**	5.7%
Total				**£192**	**100.0%**

Pooling– Active v passive?

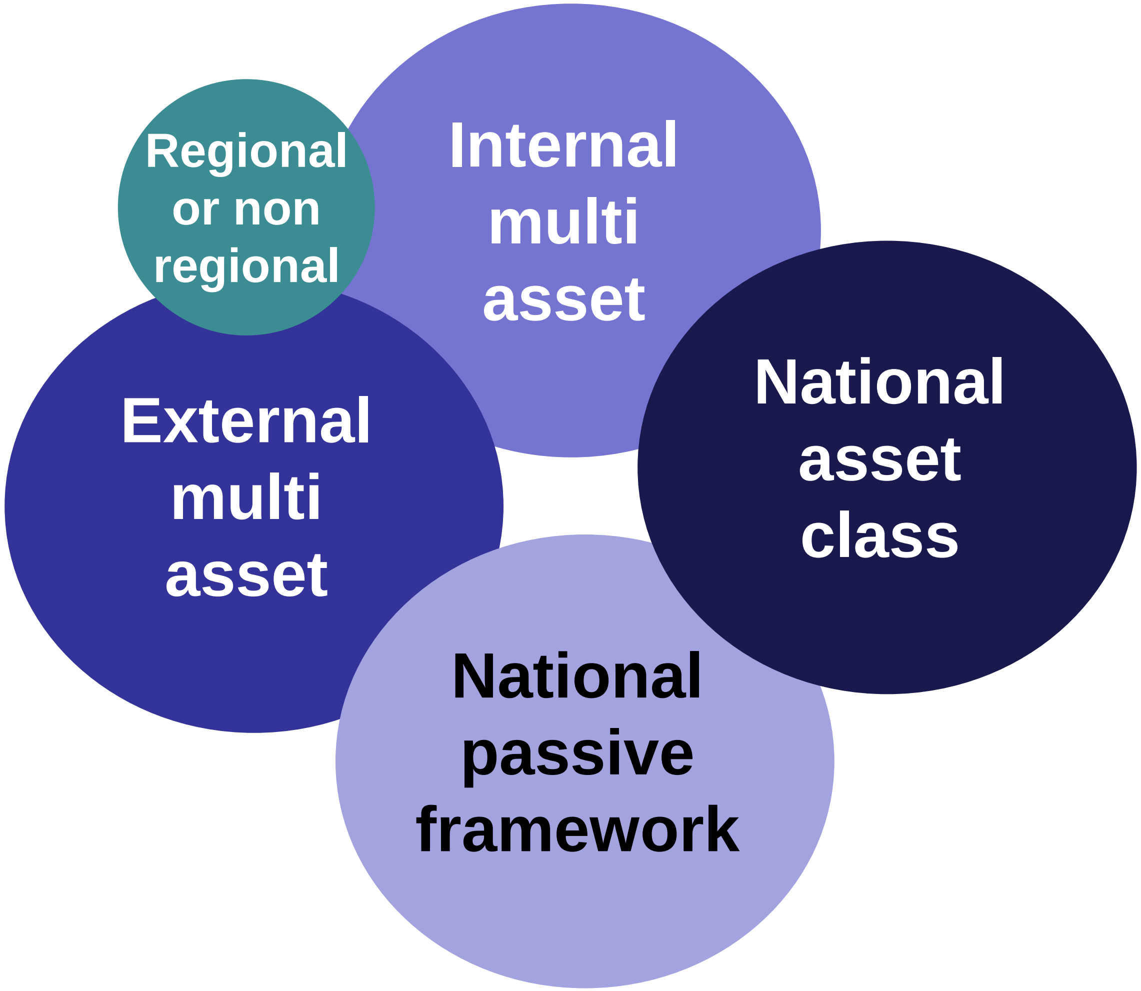


LGA Survey of funds	
No of funds	45
Total assets	£126,902,911
Passively managed	£33,224,735
Percentage	26.18%
Estimate for all LGPS	£50,267,950

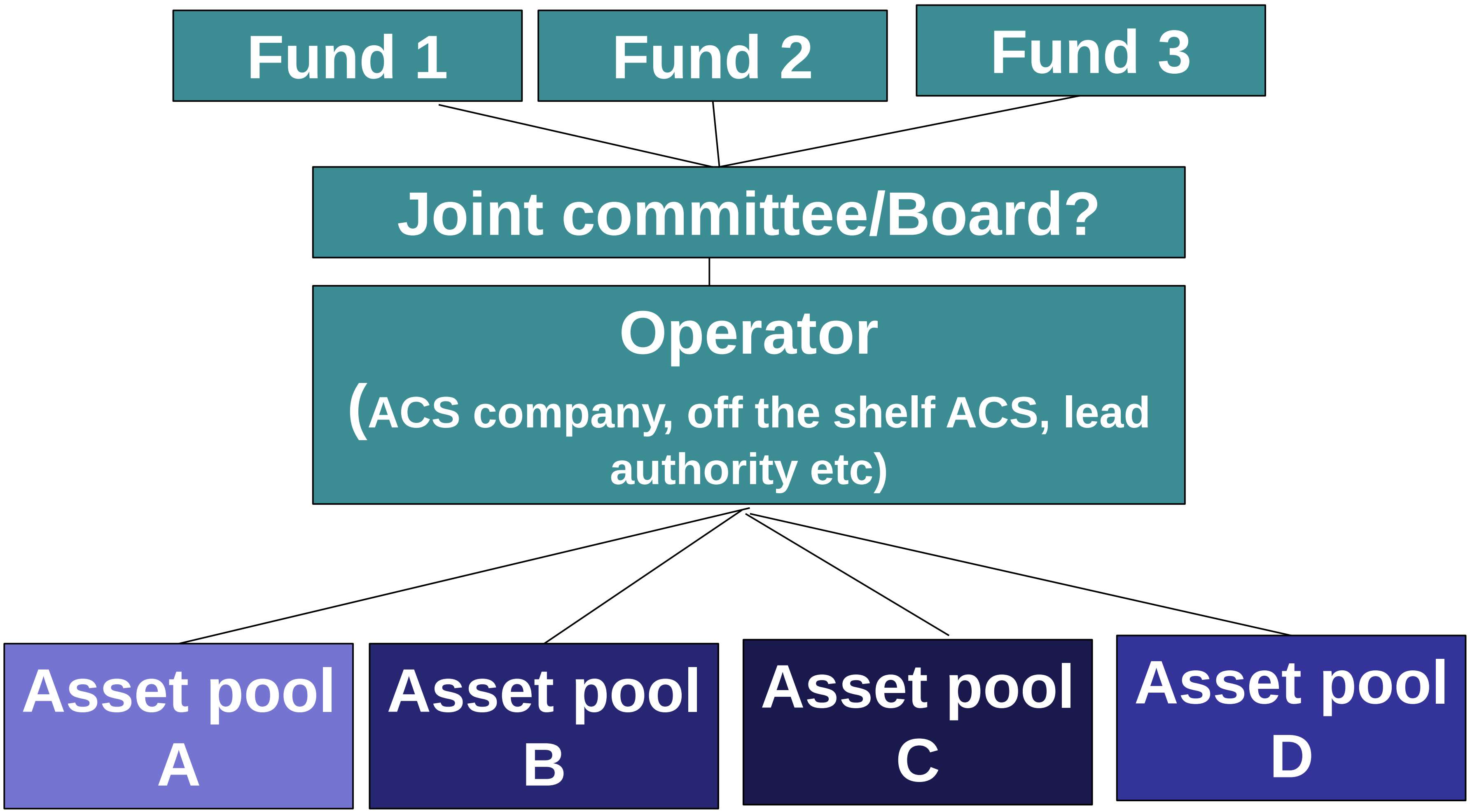
Pooling– in-house?

Fund	In-House	Total 2014	In House
Cambridgeshire	60%	£2,057,541	£1,234,525
Greater Manchester	14%	£13,284,054	£1,859,768
Islington	34%	£974,016	£331,165
Lancashire	19%	£5,188,100	£985,739
Lincolnshire	31%	£1,591,422	£493,341
London Pensions Fund Authority	15%	£4,862,167	£729,325
Merseyside	31%	£6,124,294	£1,898,531
Oxfordshire	9%	£1,631,211	£146,809
Somerset	31%	£1,469,656	£455,593
South Yorkshire	100%	£5,550,963	£5,550,963
Staffordshire	2%	£3,293,354	£65,867
Teesside	96%	£3,049,227	£2,927,258
West Midlands	46%	£10,144,400	£4,666,424
West Yorkshire	100%	£9,957,000	£9,957,000
			£31,302,308

Pooling– types?



Pooling– example CIV structure



Exit payment cost cap

- Likely to be next summer
- £95k maximum
- Includes pension strain costs
- Applies to each employment
- Unclear on transition or honouring of deals made before the effective date
- Unclear on what constitutes an exit

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