APPENDIX 2

Our Ref: PS/PM

Your Ref:

Direct Line: 0151 242 1390

Please ask for: Peter Mawdsley

Date: 23 September 2009

Mr Richard Mc Donagh
Communities and Local Government
Workforce, Pay and Pensions
Zone 5/F5, Eland House,
Bressenden Place,
London,
SW1E 5DU

Dear Richard,

LOCAL GOVERNMENT PENSION SCHEME

DELIVERING AFFORDABILITY, VIABILITY AND FAIRNESS

I refer to your letter dated 25 June 2009 and am grateful for the opportunity to respond to the issues raised for consultation.

I attach below comments on behalf of Wirral Council in its role as Administering Authority of the Merseyside Pension Fund.

In preparing this response the Council has taken advice from the Fund Actuary, Mercer. This response is submitted on behalf of the Council and has been agreed by the Pensions Committee at a meeting on 22 September 2009.

- Two possible new mechanisms are put forward in the consultation; **local funding targets (LFT)** and **financing plans (FP)**. However, we note that there is no "in principle" reason why a choice should necessarily be made between adopting either one or the other – both approaches could potentially be applied as part of agreed funding mechanisms flowing from the 2010 actuarial valuation process. In other words, the two approaches put forward are not mutually exclusive.

- In fact the two approaches could in certain applications work together in tandem. If for example, say, a 90% funding target was adopted via the LFT mechanism then this would result in the actuarial valuation setting contribution rates only intended to deliver 90% of scheme benefit payments. As (of course) the actual benefits to members of the Scheme would continue to be paid in full as they fall due, irrespective of what LFT might be adopted, a financing plan approach could then be applied, using a cash-flow methodology, to determine how the remaining, unfunded, 10% of benefits would be provided for.

  Although we have referred above to the possibility of applying a LFT of less than 100%, for practical and presentational reasons the Fund does not favour such an approach with the inevitable criticism of softening funding bases this involves. Irrespective of this, the Local Funding Target approach should in our view be recognised as more broad than simply just the possibility of adopting a funding target not equal to 100%.

There are many mechanisms already open to administering authorities (with their actuaries) to determine the funding target and objectives, via the Funding Strategy Statement (FSS) process. In this context the LFT concept might be viewed as only a relatively minor tweaking of the mechanisms already in place through the FSS process, including the consultation with employers which that process already requires.

- If either or both of LFTs or FPs are to be implemented it is clear that further and additional guidance will be required by administering authorities to assist them. This will hopefully provide a consistent framework across Funds in both interpreting any new regulatory requirements and determining their individual plans and strategies.

  The Consultation makes no reference to how admission bodies and other shorter term or less secure employers should be dealt with. The Fund would request further guidance from CLG on how any change in the funding framework can be sufficiently flexible to cater for the different circumstances of different employers, including their ability to pay a required level of contributions and the strength of their funding covenant.

- The Fund believes that the financing plan approach is, potentially the more useful of the two options put forward. Nevertheless, we would not wish to close off the possibility of considering further any potential new flexibilities which the implementation of the LFT concept could possibly allow.

- As regards the Funding Plan concept, we would request further clarification from CLG on how it is envisaged it would work in application. Would it represent either:

  a. An approach which the fund actuary may adopt, in consultation with the Fund, as part of determining and certifying the contributions payable by employers which are set out in the actuarial valuation report. This would imply that the year on year financial commitment of employers to the Fund continues to be determined solely via the actuarial contributions certificate, albeit now set in conjunction with a "Financing Plan".

  or

  b. Whether the financing plan is in some sense a response from the administering authority/employers to the actuary's valuation report and contributions certificate. In this case the implication would be that financing the scheme is only partly via contributions in accordance with the certificate, with the financing plan perhaps stating how benefits will be delivered (in the short, medium and long term) if contributions are not to be paid in full, for example due to affordability constraints. This might include a range of scenario projections with an exploration of how each possible out-turn would then be managed and financed. Clearly, in this case, the risk management analysis as envisaged in the consultation note would be particularly important.

- There is a concern that the new options, but perhaps particularly the Financing Plan approach, will make an already difficult and complex process even more complicated and lengthy, and this could be particularly so it seems if the intention of the Financing Plan concept were to follow the lines of b above.

In summary Wirral Council, as Administering Authority of the Merseyside Pension Fund, welcomes the proposals to give greater flexibility for determining contribution rates, but at the same time it is concerned that the new arrangements should not lead to any weakening of the overall funding principles for the LGPS.

It believes that it is also important to ensure that funding plans are workable and transparent for employers, thereby enabling employers to have a clear understanding of the necessary funding costs of the Scheme, so that the balance between scheme benefits and costs can be set to meet the key objectives for the LGPS, namely “affordability, viability and fairness”.

Revised Employee Contribution Tariff

The consultation paper suggests an amendment to the employee contribution rate tariffs introduced from 1 April 2008 to increase the percentage of pay rates for those earning above £30,000 per annum and to reduce the rates for the lower paid. The fact that the consultation paper refers to the original earnings bands introduced in April 2008 rather than the current revalued bands introduced from April 2009 is a potential cause of unnecessary confusion. It is understood by the Fund that the rationale for the further changes proposed is to make the scheme “fairer for the lower paid”, many of whom currently opt out of the scheme and that total employee contributions to the scheme are not intended to change.

The Fund is not supportive of the proposed amendments to the employee contribution rates for the following reasons:

further changes so soon after the introduction of tiered rates with annual indexation of earnings bands are likely to cause disproportionate administrative costs, headaches and member confusion and without delivering any improvement in the funding level of the Scheme; .

the Fund is not aware of the existence of any evidence that a marginal (0.3%) p.a. reduction in the employee contribution rate for those earning between £12,001 and £15,000 would have any effect in terms of encouraging those who have opted out of the scheme to join it; .

given the existence of means-tested state pension benefits it is debatable whether CLG should be trying to encourage lower paid members into the scheme, further analysis is required; and

the Fund understands that the biggest differential in earnings between the public and private sector is amongst those on the highest grades.

At the same time as the Government is reducing the tax relief available on pension contributions for high earners further increases in employee contribution rate of 1% for those earning over £75,000 and 2.5% for those

earning over £100,000 may well either make it more difficult to recruit and retain officers at the highest level or may lead to increased pressure on pay levels which, if it leads to higher pay, would increase past service liabilities and hence extra pension costs for employers.

The Fund would also note with regard to the issue of “fairness” that it could be argued that the final salary structure of the scheme favours those who enjoy the benefit of high pay “increases” rather than the higher paid per se.

The Fund would therefore support the suggestion that further improving the “fairness” of the scheme should only be tackled in a further stage of CLG’s review of the LGPS and only after detailed empirical investigation as part of efforts to improve the future funding position and the agreement of the new cost sharing arrangements.

<u>Acceptance of non club transfers into the Scheme</u>

Although not specifically raised in the consultation document the Fund Actuary has raised the question whether administering authorities should consider adopting the policy of refusing to allow employees to transfer in previous rights from non transfer club employers under Regulation 83 of the Administration Regulations, in order to minimise the risk of increasing funding requirements.

This proposed policy change would appear to be at variance with the current clear and explicit employee right to choose to request such a transfer set out in the existing LGPS Regulations and the Fund would request CLG to either consider amendment of the relevant regulation if such action is advisable or to at least provide guidance to authorities on this question.

If you require any further information or assistance please do not hesitate to contact me.

Yours sincerely

Director of Finance