APPENDIX A

Draft Response

Lord Hutton of Furness,

Re: Call for evidence for final report

Thank you for this opportunity to outline our views on the proposed changes to public service pensions. We administer the Local Government Pension Scheme (LGPS), Police Schemes and Fire Schemes for Wiltshire.

Scheme Design

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

It is difficult to evaluate The Local Government Pension Scheme (LGPS) schemes with others in the public sector as the LGPS is a funded scheme with assets to back up its liabilities unlike many of the other funds which operate on a Pay as You Go (PAYG) bases with the full cost being met by the public purse. The LGPS model appears a sensible approach for the long term sustainability of pension provision.

Assuming Final Salary Defined Benefits Schemes are being ruled out on the basis of being too expensive and unfair and Defined Contributions (DC) Schemes as being inadequate, the remaining options appear to be either Career Average Relating Earnings (CARE) for all or a type of Hybrid Scheme.

CARE Scheme for all members, with an accrual rate of 60ths or 70ths, would appear to meet the requirement of adequacy and with the principle being understood by employees. It addresses the fairness issue which currently favours those members who have substantial promotions or pay increases late in their working life and furthermore lower earners whose average salary will often not be significantly lower than their final salary. It also means members are receiving an equal financial unit of benefit for each pound they contribute which appears a fairer approach. This would be the most desirable scheme design if the associated costs and risks were acceptable.

Any Hybrid arrangement wouldn't be beneficial for employee understanding, while its levels of adequacy would be depend on the exact parameters. If a Hybrid Scheme is implemented, it is felt an element of defined benefit is highly desirable to ensure that employees remain in the scheme by enabling them to assess with some degree of certainty their likely levels of retirement income. A capped Career Average Scheme with 60ths accrual on the first £30,000 - £40,000 of pay and Notional DC Scheme beyond that would appear to provide an appropriate balance of adequacy, particularly for lower to medium earners who would not exceed this limit, while lowering employer costs and funding risks.

It is felt that the equalisation of benefits for the different public service pensions (with the exception of Fire, Police and the Armed Services) would help public understanding and reduce costs. There is good argument that the Fire & Police Schemes should be administered nationally considering the relative low numbers and the ad-hoc arrangements from authority to authority that are currently in place.

Risk-sharing

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

Normal Retirements Ages should (with the exception of the Armed forces, and Police & Fire Schemes) be consistent. The effect of increasing longevity should be borne by the member with increasing retirement ages in line with the state pension age. However, flexibility should be allowed to provide members with a choice of taking reduced benefits earlier.

Indexation factors could be shared between the employer and member with adjustments being made to account for changes in longevity and economic conditions. However, is would appear to be 'moving the goal posts' if applied to accrued benefits (as with the CPI issue) which increase uncertainty in the scheme.

The potential to share risks through sharing of contribution increases already exists in the LGPS from 2011 onwards. It is felt that significant variations of employee contributions from year to year (or triennially) are not acceptable because of the impact on members net pay and their personal financially planning. Meanwhile, small variations would have little effect on sharing risk.

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 reasonably balance of risk between scheme members and taxpayers?

The issue of Normal Retirement Age has been answered in Q2. Indexation factors should be aligned as closely as possible to the benefits (i.e. RPI was suitable for an inflation linked benefit) and in most cases for a funded scheme this increase can be matched by index linked gilts.

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

We have little experience of private sector pensions and therefore we are unable to effectively answer this question.

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

We have little experience of foreign pensions and therefore we are unable to effectively answer this question.

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

Its felt the target ratio should be 1/3 member to 2/3 employer as a reasonable balance. However, employee contributions rates for the lower paid should be capped at around 6% to prevent large numbers opting out based on the perceived affordability and value for money.

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

There is an argument for lower retirement ages for Police Officers, Firepersons and the Armed Services and any other similar workforce schemes to be maintained. A normal retirement age between the ages of 55 to 60 would seem appropriate considering the physical requirements of the job.

Other major schemes such as Local Government, Teachers, Civil Service and the NHS should have their normal retirement age linked to the state retirement age, although greater flexibility should be allowed for members to retire early or on flexible retirement with actuarially reduced benefits.

As discussed earlier, for the latter mentioned schemes it's believed there is good argument for making the Scheme Benefits identical for the 'non-uniform' schemes although the transition arrangements would need to be carefully considered.

It would substantially increase administrative difficulties and member confusion if distinctions where made within individual schemes (such as different types of job classification for pension purposes within Local Government).

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

If a CARE scheme is implemented the argument for different treatment is reduced and a common employee contribution rate would make more sense. If a pensions cap was introduced into the scheme for higher earners this could be enhanced by contributing into AVCs or some other form of pension provision.

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

Answered as part of Q7.

<u>Adequacy</u>
Q10. How should the Commission think about measuring adequate levels of resources in retirement?
and
Q11. What should be considered an adequate level of resources in retirement?

Measuring levels of adequacy should be on the basis of reliable poverty thresholds by area of residence. The goal should be that every pensioner receives sufficient income from state and occupational pensions so that they are not reliant on means-assessed benefits.

Ensuring a high percentage of nationwide membership of pension schemes throughout someone's working life would facilitate the reaching of this goal. A relatively low employee contribution rate for lower earners, easy to understand schemes and avoidance of low level pension provision as is now prevalent in the private sector all assist in attaining this.

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?

Yes, the combination of a full state pension and full public service pension should be at a level that is adequate for a pensioner. There are already provisions for members of the public to make additional arrangements if they wish to top up their pension provision such as Additional Voluntary Contributions (AVCs) and personal pension schemes.

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

Private sector pensions should be subject to minimum level of acceptability in terms of risk and adequacy, to reduce the current discrepancy between public and private pension provision. With time, NEST could be used as the benchmark of what is the minimum level of adequacy – this would help address the issues and principles from Q12. This would also assist in the portability of pensions between the private and public sectors.

<u>Employee understanding and choice</u>

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

Through reading reports from various organisations and speaking regularly with our own members, it is clear that the average member of a pension scheme has a poor understanding of how it works and how benefits accrue.

As a result, people can make irrational decisions regarding membership of a pension scheme. For example we are aware of members opting out of our final salary scheme because they believe that they are better off investing their money in an ISA or a personal pension scheme. Other members defer the accruing of pension benefits until they are close to retirement age without realising they don't have time to accrue an adequate pension without making substantial additional contributions. Similarly members are suspicious about the security of the pension held by the Government or companies and have unrealistic expectations of their future plans when they are older. These are issues which are in the national interest to address at both a local and national level; an easy to understand scheme design and regulations would help greatly as would increase levels of communications.

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?

Auto-enrolment is necessary to keep relatively high numbers enrolled in good final salary schemes as otherwise given the choice people can make poor long-term financial decisions. A danger of significantly increasing employee contributions rates or reducing benefits is a higher number of people will opt out all together.

Auto-enrolment in the LGPS is effective as only those who opt out within 3 months are permitted a refund. Other options that could be considered are compulsory membership or repeated auto-enrolment as we understand was proposed for NEST. There are practical difficulties with repeated auto-enrolment, while the former could appear too heavy handed and inflexible.

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

We have little knowledge of private sector pension communication.

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?

Contributions paid – on a non-DB element, it seems reasonable that contributions payable should be flexible to some degree as long as employer rates vary accordingly.

Benefits received – benefits should be actuarially decreased or increased in line with the person's age. At present in the LGPS the minimum retirement age (with reductions) is 60. This could be lowered further if the appropriate actuarial reduction is applied (e.g. 55). Otherwise actuarially decreasing and increasing pensions already occur in our main scheme and this would appear to be consistent with offering flexibility and fairness.

<u>Pensions and plurality of provision of public services</u>

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?

In the LGPS, private sector organisations are able to become admitted bodies when they take on TUPE transferred staff from an employer in the LGPS. There is a perception that LGPS employers form other sectors are almost always more risky which drives up employer rates which would be less costly in a hybrid scheme. However, two organisations are already able to take on risk sharing arrangements as part of their agreement to enter the Fund and in our Fund we have already seen this happen on a number of occasions. By expanding this fairly flexible provision to other public services schemes, we believe private sector companies would have a more level playing field to operate on.

The concept of 'Fair Deal' and protecting pension provision in line with the other protections in place under TUPE as it clear the pensions should be valued in a similar way to someone's standard remuneration package.

The 'playing field' would also be levelled further if private sector pension provision was improved alongside the reduction of any public sector pension provision.

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

There is no apparent reason why non-public service employees should not be eligible for membership of public service schemes as along as appropriate guarantees and bonds are in place, as necessary, and paid for by the non-public service person's employer. The LGPS already hosts non-public service employees as result of TUPE transfers

<u>Administration Costs</u>

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

We do not have sufficient information to make a reasonable comparison. However, care needs to be taken to ensure comparisons are made between Defined Benefit schemes in the private sector. There are also issues around scheme size and maturity profile that needs consideration.

We are aware that our administrative costs are likely to be higher than the equivalent in the private sector because of the level of complexity and lack of flexibility which exists in the Local Government Pension Scheme.

Regulatory changes and an improvement in the consultation and transition arrangements when regulations do change, as well as greater clarity over how they should be interpreted, would greatly help keep our administration costs low.

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

Please see the answers to Q20 and Q22.

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

There is certain scope for rationalising the number of local government pension funds, especially for the smaller funds. Funds could probably achieve lower investment management costs if they could procure on a larger scale and the merging of administration services could potentially benefit funds from great economies of scale but there are many issues associated from this. Issues to consider is the point where efficiencies flatten out and what happens to the service to individual members. Examples of large national providers can already be seen with schemes like the NHS which should be contrasted with the LGPS set up. The current LGPS structure does appear to be aligned with the Coalition Governments approach of decentralisation and giving more power to the local people.

What would benefit LGPS funds would be greater collaboration and closer working to prevent the duplication of costs and lead to the benefits associated from economies of scale and greater purchasing power. This has been witnessed in the South West were the funds have already set up a framework agreement for legal services and are currently tendering to establish a framework for actuarial, benefits and investment services.

As mentioned earlier the Fire and Police Schemes should be administered centrally to reduce costs due to their low membership levels in each authority.

<u>Transition Issues</u>

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

The Commission needs to strongly recommend transition timeframes that are realistic and by ensuring the new technical/administrative arrangements are clear from the beginning to ensure implementation costs are minimised.

The introduction of the LGPS Regulations 2008 is a good example where important aspects were not confirmed until at least a year after their introduction and clarifying amendments are still being made over two years later. Constant change to the benefit structure and the treatment of technical elements is highly undesirable in the interests of keeping administrative costs at reasonable levels, enhancing employee understanding and avoiding technical mistakes or issues adversely affecting current or former employees.

Although difficult to recommend a specific timeframe and process without knowing what change will occur, all administrators need to be issued with detailed draft regulations at least a year before the implementation with a detailed consultation period before and after this time. Again, in our experience, many of the transitional problems that occur would be minimal if an effective consultation process takes place as actual administrators and support authorities (e.g. advisors) are the best placed to point out technical issues, as they will be responsible for administering or advising on the new schemes on a day to day basis.

In addition an effective and efficient communication exercise for members would need to be planned in advance of the changes to ensure an understanding of the "new" scheme is taken on by members. As previously noted in general the vast majority of members are not aware of the "benefits" of being a member of the LGPS.

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

We have little awareness of the process and issues in the private sector and internationally, but as pointed out in Q23, lessons can be learned from changes made to individual schemes in the public sector.

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

We have limited knowledge of the private sector but we would comment that not providing adequate protection of accrued rights would appear to be legally challengeable and could result in a serious loss of confidence in the effectiveness of pensions and the Government as whole. Where the Commission is seeking to improve membership numbers and employee engagement in pensions, failing to adequately protect accrued rights would seem highly counterproductive.

Wiltshire Pension Fund (administered by Wiltshire Council)
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