Cost Management, Benefit Design and Administration Committee

6th January 2020
Item 8 Paper B

2O19 SECTION 13 REPORT – DRAFT GAD LETTER

Issue

1. On the 26th November, GAD submitted a draft letter to the Secretariat for consideration.

Background

The draft letter, a copy of which is attached at **Annex A**, sets out some additional areas from the 2016 report that GAD intends to consider as part of the section 13 report on the 2019 valuations. The additional areas include :-

- Consistency : treatment of age discrimination remedy costs (The McCloud case)
- Long term cost efficiency :
  - Age discrimination remedy costs and deficit reconciliation
  - Increased focus on long term cost efficiency measures.

These are explained in more detail in the draft letter.

Consideration

By way of an immediate response, the Secretariat replied to GAD in the email at **Annex B**.

The response asked for a change in wording to ensure that when testing the consistency of approach of the four actuarial firms in factoring in McCloud costs, GAD recognises that local circumstances may not be the determining factor.

Recommendation

That members of the CMBDA committee notes the Secretariat's response and considers whether any additional comments on the draft letter should be sent to GAD.

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Cost Management, Benefit Design and Administration Committee

Annex A

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26 November 2019
DRAFT

Dear Jeff

Subject: LGPS England and Wales Section 13 report as at 31 March 2019

We are grateful for the work of SAB and others in progressing the recommendations from our section 13 report on the 2016 valuations.

As stated in our report on the 2016 valuations[1], we are committed to preparing a section 13 report that makes practical recommendations to advance the aims set out in the legislation[2]. We will continue to work with stakeholders to advance these aims and expect that our approach to section 13 will continue to evolve to reflect ever changing circumstances and feedback received. We intend to engage with stakeholders throughout the process of preparing the section 13 report on the 2019 valuations, starting with the scoping of the work, moving thorough the analysis and discussion of any flags, to commenting on a draft report.

The purpose of this letter is to start that process of engagement by setting out some additional areas where we intend to consider as part of the section 13 report on the 2019 valuations, as follows:

1. Consistency: treatment of age discrimination remedy costs (the McCloud case)
2. Long term cost efficiency:
    a. Age discrimination remedy costs and deficit reconciliation
    b. Increased focus on long term cost efficiency measures

I discuss each of these areas in more detail below.

We ask stakeholders to take note of these plans, and we would welcome any comments they have on them.

[1] https://www.gov.uk/government/publications/local-government-pension-scheme-review-of-the-actuarial-valuations-of-funds-as-at-31-march-2016
[2] Section 13 of the Public Service Pensions Act 2013: http://www.legislation.gov.uk/ukpga/2013/25/section/13/enacted

Consistency: treatment of age discrimination remedy costs

As part of the section 13 report, we are required to report on whether each LGPS fund actuarial valuation has been carried out in a way which is not inconsistent with other funds' valuations.

Consistency between funds' actuarial valuations supports transparency and the administering authority's governance of the fund, by enabling the administering authority and other stakeholders to make simple comparisons with other LGPS funds. We believe that local circumstances may merit different assumptions (eg financial assumptions are affected by the current and future planned investment strategy, different financial circumstances may lead to different levels of prudence being adopted). However, differences between methodologies or assumptions that are not driven by local circumstances make it unnecessarily difficult for readers to make meaningful comparisons between funds.

The SAB provided advice to administering authorities regarding the treatment of age discrimination remedy costs (the McCloud case) on 14 May 2019[1], as follows:

> In setting employer contributions for 2020 each administering authority should, with their Actuary, consider how they approach (and reflect in their Funding Strategy Statement) the risk and potential extra costs around this matter in the same way as they would for other financial, employer and demographic risks. This should be to allow employers to be aware of and make provision for the potential cost even though any additional contributions may not commence until after the outcome is known.

MHCLG also wrote to the SAB on 28 August 2019 to emphasise it is important that authorities consider the SAB advice carefully.
We intend to review Funding Strategy Statements and actuarial valuations in this area to consider whether the approach to age discrimination remedy cost risks has been clearly stated to enable comparisons between approaches. We would expect to comment on this in our section 13 report.

Long term cost efficiency

As part of the section 13 report, we are required to report on whether the rate of employer contributions to each fund is set at an appropriate level to ensure the long term cost efficiency of the scheme, so far as relating to the fund.

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1 https://www.lgpsboard.org/images/Other/Advice_from_the_SAB_on_McCloud_May_2019.pdf

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Long term cost efficiency relates to not deferring payments too far into the future so that they affect future generations of taxpayers disproportionately. As part of our consideration of long term cost efficiency, we intend to consider:

a. Age discrimination remedy costs and deficit reconciliation

b. Increased focus on long term cost efficiency measures

Age discrimination remedy costs and deficit reconciliation

In our 2016 report, in recommendation 5, we recommended funds should not reduce contributions at the same time as extending the deficit recovery end date.

2

In view of the extra (but uncertain) age discrimination remedy costs, if employer contribution rates are decreased (reducing the burden on current taxpayers), we would expect funds to be able to demonstrate that this decision will not have an undue adverse impact on future taxpayers. In these circumstances, we would expect:

1. the deficit recovery end date should be unchanged or brought forward, compared with the 2016 valuation, and

2. prudent allowance should be made for age discrimination remedy costs

For funds where employer contribution rates have decreased, we intend to review Funding Strategy Statements and actuarial valuations for evidence that this decision will not have an undue adverse impact on future taxpayers and include comment on this in our section 13 report.

Increased focus on long term cost efficiency

Since 2016, funds have seen very strong investment returns, but the outlook for future investment returns has deteriorated following the fall in real gilt yields. Funds will need to consider future employer contribution rates carefully.

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We have developed various metrics to assess long term cost efficiency. We again expect to consider these metrics carefully and we intend to increase our focus on whether funds are paying sufficient contributions. We expect to engage with funds who perform relatively poorly on these measures and, based on that engagement, include comment in our section 13 report. For example, funds with a combination of relatively poor funding levels and relatively low contribution rates perform poorly on the 'required return' measure[2].

I hope these comments are helpful to administering authorities and their actuaries as they prepare actuarial valuations and set employer contribution rates from April 2020.

Yours sincerely
DRAFT
Michael Scanlon
Deputy Chief Actuary

Annex B

"Our only issue with the draft letter concerns the following section :-

"However, differences between methodologies or assumptions that are not driven by local circumstances make it unnecessarily difficult for readers to make meaningful comparisons between funds."

We know of at least three different approaches taken by the four firms but being blanket across all their clients, it might be difficult to argue that the different approaches are driven by local circumstances. I recall at SAB in November, Mike Scanlon saying that GAD would not be looking for identical approaches to McCloud costs but more about consistency of the approach to the legal issues and associated risks. Apologies if I have misrepresented what Mike said!

I have no doubt that each of the four firms will include in their 2019 reports an explanation of how they are treating McCloud costs in the 2019 valuation and

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[2] Required Return: The required investment return rates to achieve full funding in 20 years' time on a standardised best estimate basis

I think we can be confident that such explanations will enable comparisons to be made, albeit, on the basis of different approaches.

It is possible that the reference to "local circumstances" in the draft letter may serve to confuse rather than clarify and we would therefore propose the following alternative wording :-

"However, differences between assumptions that are not driven by circumstances or methodologies specific to the funds make it unnecessarily difficult for readers to make meaningful comparisons between funds."

Happy of course to discuss further if that would be helpful.

I should also mention that we intend giving an update on this when the Cost Management, Benefit Design and Administration committee next meets on the 6th January and the Investment committee on the 13th January."

3