

Cost Management, Benefit Design and Administration Committee

Meeting of the 14th February 2022

Item 5 Paper B

SAB Cost Management Process

1. The Board will need to consider changes to its Cost Management process (the SAB process) in light of the proposals to amend the HMT Cost Control Mechanism (CCM). The opportunity should also be taken to seek amendments to regulation to reflect lessons learned during the 2016 process.

Policy objectives for revised process

- i. Tighter integration with revised HMT CCM
- ii. Move to reformed scheme only basis (while retaining impact of underpin)
- iii. Move to 3% corridor (while retaining may/should/must)
- iv. Formally integrate impact of changes in discount rate
- v. Transition away from automatic management of the contribution ratio in existing scheme regulations

Summary of policy objectives

Closer integration (objective i)

2. Currently the CCM and the process are loosely integrated in that regulations state that where the CCM is breached no recommendations can result from the process. However, in reality 2016 proved the benefits of the Board being able to make recommendations to influence the outcome of the CCM by being aware of the direction of travel of cost pressures and the likely outcome of the CCM at a fairly early stage.
3. It is therefore proposed that the process be more closely integrated with the CCM in that regulations should formally recognise the ability of recommendations accepted by the Secretary of State (SoS) to influence the result of the CCM.
4. However, in order to maintain the primacy of the CCM the SoS should not only have the final say on any recommendations made by the Board but should also have the ability to curtail the process should it be

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obvious that no recommendations can be agreed upon. This would be particularly useful if the CCM process were being prevented from being completed within a reasonable time.

Matching the CCM changes (objectives ii, iii and iv)

5. The HMT CCM will be amended as set out below
 - it will consider movements in costs relating to reformed schemes only
 - it will include an 'economic check' based on movements in the SCAPE discount rate
 - the corridor for breaches will be expanded from 2% to 3%
6. If appropriate changes are not made to the SAB process, there is a significant danger that its ability to influence the CCM will be lessened. It is therefore proposed that the SAB process
 - moves to a reformed scheme basis but in doing so (and unlike the CCM) maintains an assessment of the impact of the underpin. The LGPS underpin is an integral part of the reformed scheme and therefore differs in both structure and impact from the ability to choose separate legacy benefits in the unfunded schemes
 - formally includes movements in discount rates (whereas the current process provides that the Board may choose to include this). Without this change the process would not be able to properly reflect and therefore influence the 'economic check' in the CCM. However, unlike the CCM the discount rate used is proposed to be one determined by the Board, taking advice from both fund actuaries and GAD
 - moves to a corridor of 3% but retains the ability to make recommendations on a may/should/must basis in order to earlier and better manage movements in scheme costs which although not breaching the corridor are structural in nature.

Contribution ratio (objective 5)

7. The current regulations provide a power for the Board to make recommendations in order to maintain the 2:1 employer/employee contribution ratio. For a number of reasons, including the potential impact of 50:50 and the wide variation of real employer contribution

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rates from those calculated under the process, such recommendations could be challenging as well as confusing to employers and members alike. It is therefore proposed that the requirements set out in regulations be more flexible in nature by asking that the Board consider the appropriateness of making any recommendations under this provision before doing so. This would retain the power but indicate the exceptional nature of the circumstances in which it should be used.

8. In common with some of the unfunded schemes it may be desirable to incorporate into regulations a requirement for there to be at least parity between employer and employee contributions – this would avoid the possibility of some employees paying a higher contribution rate than some employers.

Other suggested changes to regulations

9. Currently the regulations refer to the cost management process taking place in line with regulation 62(1)(a) (actuarial valuations of pension funds). This should be amended to bring the scheme valuation and cost management process in line with the scheme valuations in the other public service pension schemes (i.e. every four years)

The Regulations

10. The regulations governing the process are set out below together with example amendments (in bold italic) to achieve these objectives.

Recommendation – that the committee agrees to put the objectives set out in this paper to SAB for consideration and approval

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Local Government Pensions Scheme Regulations 2013

114. Scheme actuary

114.-(1) The Secretary of State must appoint an actuary as Scheme actuary to carry out valuations of the Scheme and any connected scheme in accordance with Treasury directions made under section 11 of the Public Service Pensions Act 2013(63) ("the Treasury directions").

(2) The person appointed as Scheme actuary under paragraph (1) must, in the opinion of the Secretary of State, be appropriately qualified to carry out a valuation of the Scheme.

(3) The Secretary of State must secure that the Scheme actuary carries out actuarial valuations of the assets and liabilities of the Scheme on the dates specified in ***Treasury Directions regulation 62(1)(a) (actuarial valuations of pension funds)*** and prepare valuation reports in accordance with the Treasury directions, within such period as enables the requirements in those directions to be met.

(4) An administering authority must provide the Scheme actuary with any data that the Scheme actuary reasonably requires, in accordance with the Treasury directions, in order to carry out a valuation and prepare a report on the valuation.

115. Employer cost cap

115.-(1) The employer cost cap for the Scheme is 14.6% of pensionable earnings of members of the Scheme.

(2) Where the cost of the Scheme, calculated following a valuation in accordance with Treasury directions under section 11 of the Public Service Pensions Act 2013(64) is more than the margins specified in regulations made under section 12(5) of the Public Service Pensions Act 2013 ("the Cost Cap Regulations") above or below the employer cost cap, the Secretary of State must follow the procedure specified in paragraph (3) for reaching agreement with administering authorities, employers and members (or representatives of employers and members) as to the steps required to achieve the target cost specified in the Cost Cap Regulations.

(2A) Subject to a determination by the Secretary of State under regulation 116 (2A) the calculations in paragraph (2) should take account of such recommendations made under regulation 116 (2) which have been accepted by the Secretary of State.

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(3) The procedure specified for the purposes of section 12(6)(a) of the Public Service Pensions Act 2013 is consultation for such period as the Secretary of State considers appropriate with the Local Government Pension Scheme Advisory Board with a view to reaching an agreement endorsed by all members of that Board.

(4) If, following such consultation, agreement is not reached within 3 months of **the** date on which the consultation period ends, the Secretary of State must take steps to adjust the rate at which benefits accrue under regulation 23(4) or (5) (active member's pension accounts) so that the target cost for the Scheme is achieved.

116. Scheme advisory board: additional functions

116.-(1) The Local Government Pension Scheme Advisory Board ("the Board") must obtain a Scheme cost assessment from the Scheme actuary detailing the overall cost of the Scheme and the proportions of that cost being met by Scheme employers and members on the dates specified in ***Treasury Directions regulation 62(1)(a) (actuarial valuations of pension funds)***.
(1A) The cost assessment in paragraph (1) should include the following elements:

(a) those costs relating to the reformed scheme only

(b) movements in the LGPS discount rate

(2) Subject to paragraphs (5) and (6), where the overall cost of the Scheme is above or below the target overall cost, the Board may make recommendations to the Secretary of State as to the steps to take to bring the overall cost of the Scheme back to the target overall cost.

(2A) The Secretary of State may, after consulting the Board, determine that no recommendations under paragraph (2) are achievable within such period as would not unduly delay the calculations required by regulation 115 (2).

(3) Where the proportion of the overall cost of the Scheme which is met by contributions by employers is above or below the target proportion, the Board may ***make consider the appropriateness of making*** recommendations to the Secretary of State as to the steps to take to bring the proportion of the overall cost of the Scheme which is met by contributions by employers and members back to the target ***proportion***.

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(4) The Board must, before obtaining a Scheme cost assessment under paragraph (1), prepare and publish a statement setting out its policy concerning recommendations to the Secretary of State about the steps to be taken to bring the overall cost of the Scheme back to the target overall cost and the proportions of that cost met by Scheme employers and members, back to the target proportion.

(5) The Board must not make recommendations under paragraph (2) if the Secretary of State has made a determination under paragraph (2A).

(6) Subject to paragraph (5) the Board must make recommendations under paragraph (2) if the overall cost of the Scheme is above or below the target overall cost by ~~2~~**3**% or more of pensionable earnings of members.

(7) In this regulation-

“the LGPS discount rate is such rate as shall be determined by the Board taking into account the input of fund actuaries and the Scheme actuary and the advice of the Board’s actuarial advisor”;

"the overall cost of the Scheme" means the total cost as calculated by the Scheme actuary as part of a Scheme cost assessment making use of the data provided under regulation 114(4) (Scheme actuary) according to such methodology and assumptions as are determined by the Board;

"the target overall cost" is 19.5% of the pensionable earnings of members of the Scheme;

"the target proportion" means Scheme employers meeting two-thirds and members meeting one-third of the overall cost of the Scheme.

(8) Each administering authority must provide the Scheme actuary with any data that the Scheme actuary requires in order to carry out any valuations and produce reports in accordance with directions from the Board for the purposes of this regulation.

(9) Unless the Board is prevented by paragraph (5) from making recommendations under this regulation, it must, within 23 months of the date on which a Scheme cost assessment is obtained under paragraph (1), publish a report setting out-

(a) the overall cost of the Scheme;

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- (b) the proportions of the overall costs of the Scheme met by employers and members;
- (c) the assumptions and methodology used by the Scheme actuary; and
- (d) any recommendations made to the Secretary of State under this regulation.

(10) The Board must send a copy of a report published under paragraph (9) to the Secretary of State and the Scheme actuary.

(11) The Secretary of State must publish a response to a report received under paragraph (10) within six months of the date on which that report is received.