Department for Levelling Up, Housing & Communities

Open consultation

Local Government Pension Scheme: Changes to the Scheme Advisory Board cost management process

Published 30 January 2023

Applies to England and Wales

Contents

This publication is available at https://www.gov.uk/government/consultations/local-government-pension-scheme-changes-to-the-scheme-advisory-board-cost-management-process/local-government-pension-scheme-changes-to-the-scheme-advisory-board-cost-management-process

Scope of the consultation

Topic of this consultation:

1. This consultation seeks views on proposals to amend the rules of the Local Government Pension Scheme (LGPS) in England and Wales. It covers amendments to the scheme regulations governing the Scheme Advisory Board (SAB) cost management process (CMP). The SAB 'cost management process' is provided for in regulation 116 of the LGPS Regulations 2013 and operates symmetrically, so that if valuations show that the costs of providing benefits have risen or fallen outside of a target level, recommendations must be made which would bring them back to target. A separate HM Treasury cost control mechanism takes place under section 12 of the Public Service Pension Act 2013 (https://www.legislation.gov.uk/ukpga/2013/25/contents/enacted).

2. Any changes to the LGPS rules are likely to be of interest to a wide range of stakeholders, such as local pension funds, administering authorities, those who advise them, LGPS employers and local taxpayers.

Geographical scope:

These proposals relate to England and Wales.

Impact assessment:

A full impact assessment has not been produced for this instrument as no, or no significant, impact on the private, public or voluntary sector is foreseen.

Basic information

Body/bodies responsible for the consultation:

Department for Levelling Up, Housing and Communities

Duration:

This consultation will last for 8 weeks from 30 January 2023 to 24 March 2023.

Enquiries:

For any enquiries about the consultation please contact:

Sheila.Owen@levellingup.gov.uk

How to respond:

You may respond by completing an online survey (https://consult.levellingup.gov.uk/local-government-finance/sab-cost-management-process-consultation).

Alternatively, you can email your response to the questions in this consultation to: LGPensions@levellingup.gov.uk.

If you are responding in writing, please make it clear which questions you are responding to.

Written responses should be sent to:

> Local Government Finance Stewardship
> Department for Levelling Up, Housing and Communities
> 2 Marsham Street
> London
> SW1P 4DF

When you reply, it would be very useful if you confirm whether you are replying as an individual or submitting an official response on behalf of an organisation and include:

- your name
- your position (if applicable)
- the name of organisation (if applicable)
- an address (including postcode)
- an email address
- a contact telephone number

1. Cost control in Public Service Pension Schemes

3. Following the 2010 election, the government set up the Independent Public Service Pensions Commission (IPSPC), chaired by former Labour Work and Pensions Secretary of State, Lord Hutton of Furness. Its remit was to conduct a fundamental structural review of public service pension provision. In the final report (2011) (https://www.gov.uk/government/publications/independent-public-service-pensions-commission-final-report-by-lord-hutton), the Commission stated its aim was to recommend a structure that would include sharing the risks and costs of public service pensions fairly between employees and Government.

4. The government accepted the IPSPC's recommendations and cost management processes were legislated for by HM Treasury for all public service schemes under section 12 of the Public Service Pensions Act 2013 (https://www.legislation.gov.uk/ukpga/2013/25/section/12).

5. In addition, as a funded scheme under section 13 of the Public Service Pensions Act 2013 (https://www.legislation.gov.uk/ukpga/2013/25/section/13) the 86 individual LGPS administering authorities also carry out local valuations to determine the contributions to be paid by employers in the individual funds. Apart from setting employer contribution rates local fund valuations also assess if administering authorities are on target to meet their pension liabilities as they fall due in years ahead. Employer contribution rates are mainly determined on an individual employer basis and consider several factors - related either to the individual employer (such as membership demographics) or related to the fund more broadly (such as the performance of fund investments since the previous valuation).

2. Cost control in the LGPS (England and Wales)

6. All main public service pension schemes are subject to 4-yearly valuations by the Government Actuary's Department (GAD) (https://www.legislation.gov.uk/ukpga/2013/25/section/11) at which the value of pension benefits today that will be paid in the future are assessed . In the unfunded schemes, the scheme valuations are used to set the employer contribution rate but in the LGPS, with employer contributions set locally, the

main relevance of the scheme valuation is to assess costs for the purposes of the Cost Control Mechanism (CCM). At the time of introduction, it was agreed that the LGPS (England and Wales) SAB would operate an additional check on scheme costs and the way they are shared between employers and employees. The SAB Cost Management Process (CMP) is provided for in regulation 116 of the LGPS Regulations 2013 (https://www.legislation.gov.uk/uksi/2013/2356/regulation/116).

7. As with the HM Treasury CCM the SAB CMP aims to manage costs in the LGPS. However, the SAB CMP differs from the main HM Treasury CCM in that:

- The SAB CMP has target costs of 19.5% employer and employee contributions (with a 2/3rd to 1/3rd respective split) as provided for in regulation 116(7) of the LGPS Regulations 2013 (https://www.legislation.gov.uk/uksi/2013/2356/regulation/116)
- The SAB CMP can use different assumptions around the cost of providing member benefits, for example, it can use a different discount rate to reflect that LGPS is a funded scheme. In addition, it takes into account the level of take up of the 50/50 section of the scheme which provides the flexibility to pay half the normal member contribution and build up half the normal pension, which is entirely excluded from the HMT CCM.
- The SAB CMP allows for different criteria for when corrective action is taken to move the scheme back to target cost in a broader range of circumstances, namely:
- A movement of between 0% and 1% from the target in either direction may result in agreed recommendations for action to move back to the target,
- A movement of between 1% and 2% from the target in either direction should result in agreed recommendations for action to move back to the target,
- A movement of 2% or more from the target in either direction must result in agreed recommendations for action to move back to the target.

8. The SAB CMP operates prior to the HM Treasury CCM, and recommendations made as a result (and accepted by government) are considered when calculating the scheme costs (for the purpose of the HM Treasury CCM).

3. The 2016 Scheme Valuations and Government Actuary review

9. The first assessment of scheme costs under the main HM Treasury CCM were undertaken as of 31 March 2016. Provisional 2016 cost control results indicated a breach of the cost cap floor for all schemes for which results were assessed.

10. In the context of these provisional results government announced that it was asking the Government Actuary to review the CCM for future exercises. The key drivers of the indicative floor breaches were a reduction in the assumed level of future pay increases and a reduction in assumed life expectancy. Neither of these reasons necessarily seemed to fit the category of ‘extraordinary, unpredictable events’, which it was originally intended would be the trigger for benefit rectification under cost control. This therefore raised the question of whether the CCM as designed was too volatile.

11. The operation of the HM Treasury 2016 CCM (https://commonslibrary.parliament.uk/research-briefings/sn06971/) was paused at the end of January 2019 due to uncertainty about scheme costs following the Court of Appeal judgment in McCloud v Lord Chancellor (https://www.judiciary.uk/wp-content/uploads/2018/12/lord-chancellor-v-mcloud-and-ors-judgment.pdf) (PDF, 699KB). This held that the “transitional protection” offered to some members as part of the 2013 Act reforms amounted to unlawful discrimination.

12. In July 2020 the government lifted the pause (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901141/Update_on_the_Cost_Control_Element_of_the_2016_Valuations.pdf) (PDF, 139KB), as progress in determining the increase in value of member benefits as a result of the McCloud remedy meant costs were now more certain. It was decided that the cost of the remedy would count as a “member cost” in the completion of the 2016 valuations.

13. In October 2021, the government published amending directions for completion of the 2016 valuations (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1023845/The_Public

_Service_Pensions__Valuations_and_Employer_Cost_Cap___Amendment__Directions_2021.pdf) (PDF, 209KB). A letter from the Government Actuary confirmed that the amending directions reflected government's policy intention that the impact of the McCloud remedy should be considered in the 2016 valuations.

4. Changes to the HM Treasury Cost Control Mechanism from 2020 Valuations

14. Following the Government Actuary's review of the HM Treasury CCM (https://www.gov.uk/government/publications/cost-control-mechanism-government-actuarys-review-final-report) a consultation (https://www.gov.uk/government/consultations/public-service-pensions-cost-control-mechanism-consultation) was launched in June 2021 on 3 proposals:

- A redesign of the CCM – to ensure it only considers past and future service benefits built up in the reformed schemes with all legacy scheme costs excluded,
- Widening the corridor from 2% to 3% of pensionable pay, thereby reducing the regularity of breaches, and
- Introducing an economic check, so that a breach of the mechanism would only be implemented if it would still have occurred had the impact of any change in long-term economic assumptions been considered.

The government published a response to the consultation (https://www.gov.uk/government/consultations/public-service-pensions-cost-control-mechanism-consultation) in October 2021 which confirmed its approach and that the three changes above would be taken forward. Government legislation (https://www.legislation.gov.uk/uksi/2022/787/contents/made) was laid in Parliament in July 2022 to widen the cost corridor so that costs can vary more from target before action is taken.

5. Changes to cost control in the LGPS

15. Following the changes announced to the HM Treasury CCM, the SAB considered the changes it wished to make to the operation of the SAB CMP to ensure the processes remained generally aligned. A final policy paper (https://lgpsboard.org/images/CMBDA/SABCM140222.pdf) (PDF, 172KB) was considered by a SAB committee in February 2022 and approved by the Board in March 2022 .

16. The SAB has considered whether it would be desirable for their process to be adapted in line with the principles of the economic check, as referred to in paragraph 3.32 of the HM Treasury's October 2021 response to the cost control consultation (https://www.gov.uk/government/consultations/public-service-pensions-cost-control-mechanism-consultation) (see also paragraph 14 above). However, the SAB has decided it would be preferable to reflect wider pressures on LGPS costs in the SAB process by considering changes in the LGPS discount rate, as determined following advice by its actuary. The government is content with this approach.

17. This consultation outlines changes to the regulations governing cost control in the LGPS which the Government considers are desirable or necessary following the SAB review. The Government remains of the view that there should be flexibility in how the HM Treasury CCM, and the SAB CMP interact and have not proposed changes to the regulations which limit flexibility in a way we consider undesirable. Our expectation remains that – as mentioned in paragraph 8 above – the SAB CMP will continue to operate prior to the HM Treasury CCM.

18. The proposed changes in the draft regulations are described in the following sections.

6. Correcting the regulation cost control dates to align with other public sector scheme valuation dates

19. Scheme regulation 114(3) (https://www.legislation.gov.uk/uksi/2013/2356/regulation/114) currently requires that the actuarial valuation for the HMT CCM takes place in line with the actuarial valuations of pension funds. These are the local fund valuations which take place every 3 years (see paragraph 5). We propose to update

this for consistency with HMT directions (specifically the The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions 2018 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/758842/23_November_2018_Signed_Directions.pdf) (PDF, 13.4MB) which moved the HMT CCM for LGPS onto a 4 year cycle). Regulation 116(1) also requires that the SAB CMP takes place in line with the three yearly actuarial valuations of pension funds, and we also propose to update this to four years for consistency with the HMT CCM. Amending the regulations to bring the scheme valuation and cost control process in line with the scheme valuations in the other public service pension schemes every four years will align the government and SAB mechanisms and allow the SAB CMP to operate immediately prior to the HMT CCM.

> Question 1 - Do you agree that scheme regulations should be amended so that the SAB CMP is aligned with the scheme valuations (every 4 years) in the other public service pension schemes?

7. Removing the requirement for SAB recommendations to bring the scheme back to target cost

20. Scheme regulations (https://www.legislation.gov.uk/uksi/2013/2356/contents) currently require the SAB to make recommendations to bring the cost of the scheme back to the target cost. Additional flexibility can be provided by amending the regulations so that if the Board decide to make recommendations, they do not need to recommend the costs move back to target. This additional flexibility can act to address cost changes in the LGPS as they arise. We propose recommendations may be made to move towards, or to, the target cost but not beyond the target cost.

21. Regulations also require that if the overall cost of the Scheme is more than 2% from the target cost in either direction, the SAB must make recommendations to bring the scheme back to target. This is inconsistent with our flexible approach set out above and we propose removing this in its entirety. This would mean that the SAB is able, but not required, to make recommendations when costs differ from the overall target cost.

22. However, it should be noted that if following the implementation of recommendations made by the SAB following the CMP process, there is still a breach under the HM Treasury CCM, then action will be taken by the Government to bring costs back to target.

> Question 2 - Do you agree that regulations should be amended to provide additional flexibility if the Board decide to make recommendations on cost?

8. Economic check in the LGPS

23. Regulation 115(2) of the LGPS Regulations 2013 (https://www.legislation.gov.uk/uksi/2013/2356/regulation/115) provides that the government must take steps to bring the Scheme back to the target cost where there has been a breach of the corridor under the HM Treasury CCM.

24. As set out in paragraph 14 above, an economic check is being introduced to the cost control mechanism. This will mean that a breach of the mechanism will only be implemented if it would still have occurred had the impact of any change in long-term economic assumptions been considered.

25. Technical details of the economic check will be introduced by government via the valuation directions (https://www.legislation.gov.uk/ukpga/2013/25/section/12/enacted). These will set out in detail how the economic check will work. Depending on what the directions require, it may be necessary for us to amend regulation 115(2) (https://www.legislation.gov.uk/uksi/2013/2356/regulation/115) to ensure that changes to the Scheme are only necessary after consideration of the economic check. If this is the case, we will consult with the SAB and ensure any change is technically accurate before we implement.

> Question 3 - Do you have any comments on our proposal in paragraph 25?

9. Public sector equality duty

26. The Department for Levelling up, Housing and Communities has considered the proposals set out in this consultation document to fulfil the requirements of the Public Sector Equality Duty as set out in section 149 of the Equality Act 2010. This requires the department to pay due regard to the need to:

1) eliminate unlawful discrimination, harassment and victimisation and other conduct prohibited by the Act

2) advance equality of opportunity between people who share a protected characteristic and those who do not

3) foster good relations between people who share a protected characteristic and those who do not.

We have made an initial assessment under the duty and do not believe there are equality impacts on protected groups from the proposals at paragraphs 19 to 25 which set out changes to the SAB CMP, as there would be no change to member benefits arising from these procedural adjustments. These are procedural changes which will not affect member benefits. Any proposals to amend scheme benefits in the future - for example, following a breach of the cost control mechanism - would need to be considered against the requirements of the Public Sector Equality Duty at the time.

> Question 4 - Are you aware of any equalities impacts or of any particular groups with protected characteristics who would be disadvantaged by the proposals contained in this consultation?

10. Statutory Instruments

2023 No.

Public Service Pensions, England And Wales

Local Government Pension Scheme (Governance) (Amendment) Regulations 2023

Made ***

Laid before Parliament ***

Coming into force ***

The Secretary of State makes the following Regulations, in exercise of the powers conferred by sections 1, 3, 7, 11(1), 12(6) and 13 of the Public Service Pensions Act 2013([23]).

In accordance with section 21 of that Act, the Secretary of State has consulted the representatives of such persons as appear to the Secretary of State likely to be affected by these Regulations.

In accordance with section 3(5) of that Act, these Regulations are made with the consent of the Treasury.

Citation, commencement and extent

1.—(1) These Regulations may be cited as the Local Government Pension Scheme (Governance) (Amendment) Regulations 2023 and come into force on ***.

(2) These Regulations extend to England and Wales.

Amendment of the Local Government Pension Scheme Regulations 2013

2.—(1) The Local Government Pension Scheme Regulations 2013([24]) are amended as follows.

(2) In regulation 114(3), for "on the dates specified in regulation 62(1)(a)(actuarial variations of pension funds)", substitute "on the dates specified in Treasury directions".

(3) [Revision to regulation 115 (employer cost cap) – please refer to paragraphs 23-25 of the consultation].

(4) In regulation 116—

(a) in paragraph (1) for "on the dates specified in regulation 62(1)(a)(actuarial variations of pension funds)", substitute "on the dates specified in regulation 114(3) (Scheme actuary) in relation to actuarial variations".

(b) in paragraph (2)—

(i) omit "and (6)";

(ii) after "bring the overall cost of the Scheme back to", insert ", or towards";

(c) in paragraph (3) after "contributions by employers and members back to", insert ", or towards";

(d) in paragraph (4) after "the proportions of that cost met by Scheme employers and members, back to", insert ", or towards";

(e) omit paragraph (6).

Signed by authority of the Secretary of State for Levelling Up, Housing and Communities

Name

Minister of State

Date Department for Levelling Up, Housing and Communities

We consent

Name

Name

Two of the Lords Commissioners of His Majesty's Treasury

Date

([23]) 2013 c.26; sections 3, 7, 11 and 12(6) were amended by the Public Service Pensions and Judicial Offices Act 2022 (2022 c.7).

([24]) S.I. 2013/2356; regulations 114 and 116 inserted by S.I. 2015/57.

Explanatory Note

(This note is not part of the Regulations)

The Local Government Pension Scheme Regulations ("the 2013 Regulations") established the Local Government Pension Scheme ("the Scheme").

Regulation 2(2) of this instrument amends regulation 114 of the 2013 Regulations. This amendment changes the date on which the Scheme actuary must carry out a valuation of the scheme, to align with the dates specified in Treasury directions made under section 11 of the Public Service Pensions Act 2013 ("the 2013 Act").

Regulation 2(3) of this instrument amends regulation 116 of the 2013 Regulations. These amendments change the date on which the Local Government Scheme Advisory Board ("the Board") must carry out an assessment of the cost of the Scheme, to align with the dates specified for the Scheme actuary's valuation under regulation 114. These amendments also provide that the Board must take out independent actuarial advice in determining its assessment of the Scheme cost. These amendments also make further provision in relation to the exercise of the Board's recommendation-making functions under regulation 116.