Sustaining the LGPS in England and Wales
Cosh Sharing Mechanism – CLG consultation Questions: 1-14

1. Consultees may wish to consider and comment on how best the range of relevant views on governance could be involved as part of this exercise, and how these might be factored into the exercise, and at what particular stages?

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If a cap on employer contributions is introduced it will, if investment returns were to be included in the mechanism, add weight to the unions claims for "Member Nominated Trustee" voting rights on the Pensions Committee.

2. As the cost-share mechanism is already a statutory requirement of the new LGPS, from 1 April 2008, consultees' views on how most effectively to take the process and delivery of the whole exercise forward would be welcomed.

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3. It may be that some of the actual content of each of the above stages (and others) could be set in the regulatory framework, for example in a dedicated schedule to a statutory instrument or, alternatively, in statutory (or non-statutory) guidance prepared by CLG. Consultees' views would be welcomed on this aspect.

There needs to be an agreed timetable for the provision and collation of information and the date from which the outcomes from each triennial exercise should be implemented. This should be in statutory guidance (rather than regulation) in order to reflect the fact that timetables for each triennial cost sharing exercise might need to change (and changing guidance is easier than changing a Statutory Instrument).

4. Do consultees envisage any problems in providing detail as set out in paragraph 20 (types of cost risk)?

Funds do not hold details of the current marital, civil partnership or co-habiting partner status of individuals.

5. Consultees' views on approaches to maintaining longer term sustainability are invited.

The introduction of the cost sharing mechanism is essential to ensure the longer term affordability and sustainability of the Scheme.

6. Consultees' views are invited on the three columns' contents (see pages 7 to 9 inclusive) and further suggestions and commentary will be welcomed.

There is a trade off between
a) the complexity and possible volatility of the GAD model which best protects the interests of employers, of tax payers and the longer term sustainability of the Scheme, and
b) a less complex and volatile model that would be easier to understand and administer but which might offer less protection for the interests of employers, of tax payers and the sustainability of the Scheme. This would concentrate on a few key issues (such as longevity) and costs arising from longevity trends could be dealt with via an increase in the Scheme's normal retirement date (perhaps in line with the increase in the State Retirement Age).

On balance, we believe that we need to accept the greater complexity of the GAD model as the price for seeking greater longer term sustainability.

It should be recognised that the items in the cost sharing list might need to change over time to reflect new factors and changing circumstances.

7. It is suggested to consultees that surpluses or deficits which exist in the local funds at the commencement date of the model scheme would be excluded from the notional fund and should not form part of any cost-sharing envelope, as these are related to experience which occurred <u>prior</u> to the implementation date. Views on such an approach are therefore sought.

We agree with the proposed approach.

8. The current 2007 actuarial valuation average amortisation period could, at the outset, be adopted in the notional fund. Views are sought on whether this approach – or some other approach would provide stability (see paragraph 32).

This seems a reasonable approach at the outset, with future amortisation periods being set to reflect average periods at subsequent valuations (which in turn will be a reflection of whether funds are in deficit or surplus, with shorter amortisation periods expected at times when Funds are in surplus).

9. Consultees are asked to consider if inter-valuation experience impacts on cost sharing calculations?

We are not clear exactly what the question is asking. We believe that changes since the last triennial valuation should be taken into account but do not believe there should be inter-valuation reassessments.

10. Consultees' views on ill health and related experience issues are sought (see paragraph 38).

We agree with the smoothed best estimate approach.

11. Consultees' views on how best to achieve inter-generational balance are invited (see paragraph 39).

No system will be perfect and there will be intergenerational inequity e.g. current contributors will have to meet the cost of not only their own increasing longevity, but also that of members who have left (with a preserved pension or pension in payment) and who are no longer able pick up their share of the increasing cost (as they no longer make contributions to the Scheme). Whilst this is far from perfect we believe that this has to be accepted.

12. (a) The share need not necessarily be 50:50; consultees may wish to consider the range of possible alternatives and (b) to justify alternative ratios as part of this informal consultation exercise.

We agree a 50:50 ratio subject to the cap on employer contributions.
One potential issue is that scheme member's may find it difficult to understand why, for example, their contribution rate has to increase (because of increases in the cost of those elements included in the cost sharing basket) if, at the same time, funds are in surplus due to good investment returns (which are not proposed to be included in the cost sharing basket).

13. Consultees' views are invited on the principle of a notional cap within the cost share framework, and on its initial level going forward from April 2009.

We agree that there should be an employer cap and accept the 14% cap as an indicative rate. However, ideally we need to avoid 3 yearly fluctuations in the employee contribution rates, or benefit structure, or NRD. Changes to one, some or all of these should only occur once a longer term trend is established; short term fluctuations within set parameters should be smoothed.

14. (a) Consultees' views on the most appropriate and beneficial timetable position are invited, given the objectives set out in paragraph 18. (b) Consultees may also wish to comment on the timetable and process needed to establish the cost share arrangements, given the 31 March 2009 regulatory timetable and the earliest date from which the results of the first cost share (should one be needed) is implemented.

We believe that the aim should be to implement cost sharing from April 2011. Any decision on the implementation of a cost share must clearly be based on appropriate data and professional advice, and be both transparent and robust. Ultimately, however, it must be for the Minister to decide, following a statutory consultation, on how (e.g. via an increase in employee contributions, reduction in benefits package or change to the normal retirement date), and when, to implement the outcomes resulting from each triennial assessment.

The last GAD cost sharing paper presented to the PRG included an appendix setting out a possible timetable. It seems to us that the timescales suggested are not workable given the need to have a process completed in time for budget setting purposes in the Autumn of 2010 (or the Autumn of 2011 if cost sharing is not implemented until April 2012). If the GAD model is to be taken forward we would suggest some changes to the timetable as shown in the table on the next page.

		Implementation April 2011	Implementation April 2012
1	Cost share methodology agreed and finalised by:	End of 2008	31 March 2009
2	Prior to the notional fund start date (either 31 March 2009 or 31 March 2010) a data specification is sent by GAD to the local funds actuaries setting out the information that they will require, either based on a 2009 data extract or being used for the 2010 round of valuations.	Prior to 31 March 2009	Prior to 31 March 2010
3	Valuation membership data supplied to the fund actuaries.	Change from 31 July 2009 to 30 September 2009	Change from 31 July 2010 to 30 September 2010
4	If GAD is to determine a central basis using experience data, experience and membership data is provided to GAD in the format specified in (2) above.	Change from by 31 August 2009 to by 31 October 2009	Change from by 31 August 2010 to by 31 October 2010
5	The actuaries have analysed the membership data, decided on the assumptions they propose to adopt locally and submitted their best estimates to GAD. This stage is obsolete if GAD is to determine a central basis using experience data.	Change from 30 November 2009 to 31 December 2009	Change from 30 November 2010 to 31 December 2010
6	GAD analyses the local assumptions (and/or experience data) and puts forward to the Policy Review Group a proposal on the model assumptions to be adopted.	28 February 2010	28 February 2011
7	The Policy Review Group considers, and gives its view on, the assumptions to be used. GAD is then instructed to run the assumptions through the model.	Change from by 31 May 2010 to by 31 March 2010	Change from by 31 May 2011 to by 31 March 2011
8	The agreed assumptions have been run through the model scheme and the results compiled. The output includes a model recommended employer rate, and the resulting member rate under the agreed cost share mechanism.	Change from by 30 September 2010 to by 31 July 2010	Change from by 30 September 2011 to by 31 July 2011
9	The Review Group discusses the cost share result and gives its view. The resulting member rate is fed back to the fund actuaries so that they can advise on the local impact on the employer rate. Alternatively if it is decided to adjust members' benefits, then this too is fed back locally.	Change from by 30 November 2010 to by 30 September 2010	Change from by 30 November 2011 to by 30 September 2011
10	Cost sharing implementation.	April 2011	April 2012

Comments on table:

Box 3) We believe that the supply of all data by 30 September would be more sensible. Reported experience for the 2007 valuations is that a significant number of administering authorities were unable to supply data to their actuaries by the end of August and, indeed, several were not able to do so until well into September. Some administering authorities had encountered significant problems where an employing authority had changed payroll system in the last year or so.

Box 4) We can see no particular reason why 3) and 4) could not be combined. The implication is that the data needs to come via the Fund actuaries, but we are not sure this needs to be the case, and could as easily be provided direct to GAD as to the Fund actuaries.

Box 7) The revised date in 7) above is still probably very tight. The solution could be to bring item 6 back a month to 31 January. If GAD are doing their own analysis, that would give them 4 months to do it. If the preliminary analysis is being done by the Fund actuaries, then we would suggest bringing 5) back to 15 December.

General comments:

Our expectation is that problems with employers submitting data in time for the administering authority to meet the deadlines in the table will keep recurring and thus, irrespective of timetable, some compromises on data quality will need to be made.

If the notional fund route is progressed there is a good case for the starting data to be based on 2007 valuation data:

a) from a practical perspective, to ensure that base data is as comprehensive as possible at the outset, and
b) because it might help with the theory and in determining initial assumptions (irrespective of the basis subsequently determined).