Appendix 'A'

Report of the Independent Public Service Pensions Commission

Introduction

The final report of the Independent Public Sector Pensions Commission chaired by the former Labour Cabinet Minister Lord (John) Hutton was published on 10th March 2011. The Commission was established by the Chancellor of the Exchequer to examine the nature of reforms to the whole public sector pensions system to place it on a sustainable basis.

While the Local Government Pension Scheme (LGPS), of which the Lancashire County Pension Fund is part, forms part of the overall public sector pensions landscape it is significantly different to the bulk of schemes in that it is a funded scheme. All the same the Commission's conclusions are as applicable to LGPS as to other schemes.

The Commission proposes a new pensions "deal" for the public sector supported by a range of automatic stabilising mechanisms intended to share risk on an appropriate basis between scheme beneficiaries and employers and tax payers.

This "deal" is set within a context built on two important pillars:-

- Firstly, pensioner saving is a "good thing" which should be encouraged, not least because it has the potential to reduce the potential calls on other areas of public expenditure such as the benefits system.
- Secondly, it is not appropriate to engage in a "chase to the bottom" in terms of the quality of pension provision in the public sector.

The Commission has designed its proposals around four principles; that any new scheme should be:

- affordable and sustainable;
- adequate and fair;
- support productivity; and
- transparent and simple.

The Deal

The table below summarises what the report describes as the deal between public service workers and taxpayers:

Public service workers

•A good pension in retirement:
A level of pension that at least meets agreed adequate standards of Pension - taken together with full state pension this should deliver on average more than two thirds of pre-retirement salary for those below median income.

•A defined benefit pension:
A pension based on average salary indexed by average earnings over a member's career. This should benefit the majority of members who do not have the high salary growth rewarded in a final salary scheme.

•Accrued rights protected:
The years a member has already worked will provide a pension at the current pension age linked to a members final salary. This will protect existing staff from the full impact of a change from a final salary scheme to a career average in proportion to their age and career length.

•Fair process of change:
The details of change should be the subject of consultation with staff and unions.

•Better management of schemes:
Improved standards of governance and administration with staff Involvement through member representation.

Taxpayers

•Fairer sharing of the benefits of living longer:
Public service workers will over time be expected to work longer - most to state pension age - before they take their pension. This will rebalance the proportion of adult life spent in retirement.

•Future-proofed:
Pension age in most public service schemes will be expected to keep in line with changes to life expectancy through a link to state pension age changes.

•Fixed cost:
The Government should establish a fixed cost for the employers' contribution to public service pension schemes. If cost grows beyond this level then action will be taken to get back to this level.

•Greater transparency of cost:
Figures for the current and future expected cost of public service pensions should be published more regularly, consistently and transparently.

•Single legal framework:
Public service pensions should have a new legal framework with consistent approach to control and governance.

The "deal" is intended to provide considerably greater clarity for scheme beneficiaries, employers and taxpayers on what they can expect of the public service pension system.

Importantly the element covering "a good pension in retirement" also acts to promote pension saving through setting an objective that a combination of earned pensions and state pension should provide an income which avoids the need to access means tested benefits in retirement. This should provide a significant positive marketing point to encourage scheme membership.

Scheme Design

While the Commission favours the retention of a defined benefits structure it does make recommendations for a fundamental change in the way in which that benefit is calculated.

What is proposed is a career average revalued earnings (CARE) scheme. This means that benefits will be calculated based on average earnings over the period of scheme membership adjusted in line with average earnings.

This form of scheme design will make little difference to the benefits payable to a large proportion of scheme members who see their pay vary within a relatively narrow band over their career. It will, however, impact on so called "high flyers" who see significant increases in salary over a career. For these members the scheme will still represent good value relative to alternatives and the Commission takes the view that higher earners are more able to make additional provision from retained income.

The Commission argues for a single basic scheme design across the public sector with a normal retirement age set at 65 (60 for the uniformed services) rising in line with the state pension age. The normal retirement age in LGPS is already 65 so this represents no change. However, the Commission also states that scheme members should have greater choice over when to take benefits, subject to actuarial adjustment. It also proposes measures to increase the attractiveness of flexible retirement. This latter has in the past attracted some criticism, viewed as "double dipping", but is viewed positively by the Commission in the context of workforce planning and the ability for scheme members to ensure adequate incomes into eventual full retirement.

One key feature is the proposal that there should be a fixed cost ceiling for taxpayer support for public sector pension schemes. The Commission does not define the ceiling but says that if negotiations to bring costs within the ceiling are unsuccessful then there should be a default method for achieving this, presumably though increasing employee contributions. It is not clear how this fits with the expectation within the Comprehensive Spending Review that the Local Government Pension Scheme will contribute £900m to HM Treasury over the next three years (intended to be achieved through increasing employee contribution rates.)

In terms of implementing the proposed changes the Commission is very clear that it is **not** proposing a single public services pensions scheme, rather a common framework for public service pensions, which should also apply to LGPS which should remain a funded scheme.

The Commission also expresses the clear view that "it is in principle undesirable for future non –public service workers to have access to public service pension schemes" given that ultimately this places a financial risk with the tax payer as the financial backstop for these schemes. This recommendation has significant implications for the admitted body arrangements currently operated by LGPS Funds; particularly in relation to the contracting out of services where the

Government has recently announced the abolition of the "two tier" code relating to pension rights in outsourcing arrangements.

Governance and Transparency

The Commission makes a range of recommendations in relation to improving the overall system for managing pension provision in the Public Sector, although it acknowledges that LGPS Funds already exhibit considerable good practice in this area.

The specific recommendation is that a "properly constituted trained and competent Pension Board with member nominees" should oversee each scheme. In terms of LGPS this would create for the first time, a formal body at national level responsible for the scheme as a whole, while the existing local pension Committees would continue to operate the individual funds. In Lancashire the Committee already includes representatives of scheme members with voting rights.

The Commission is very clear that scheme members should be able to easily access information on the benefits which they are accruing. To support this they recommend the production of annual benefits statements and easy online access to information both of which have existed in Lancashire for some time.

The Commission considers it important that the performance of schemes and funds in terms of both administrative costs and investment should be regularly monitored and benchmarked while the long term cost of public service pensions should be regularly reviewed. The Lancashire County Pension Fund already regularly benchmarks costs and performance and in terms of scheme administration also makes comparisons with wider industry norms so this will not represent a significant change for the Fund.

The Commission also seeks to encourage the development of increased collaboration and sharing of services between LGPS funds. This is an area where Lancashire County Council is leading the way having recently taken responsibility for administering pensions on behalf of the Cumbria Pension Fund.

Implementation

The Commission suggests it would be helpful for the framework it is suggesting to be incorporated in new primary legislation with changes introduced before the end of the current parliament. It is also suggested that the implementation process should be centrally managed across all schemes.

There are also important details of the final schemes such as accrual rates and the automatic cost stabiliser which would need to be negotiated and consulted upon. Given all this it seems likely that any new scheme would only become operational around 2015 although considerable work will be required before this.

Conclusion

Given the content of the Commission's interim report there are no real surprises in this final report. The steps suggested will have some positive impact on the Fund's liability position but this would accrue over a very long timescale. The proposals also increase the risk of a reduced take up of scheme membership, which could significantly impact on investment strategy if it results in the Fund reaching maturity earlier than current actuarial forecasts indicate. The Local Government Association has been making ministers aware of this risk and has asked for it to be factored in to the negotiations around implementation. This is an area where the funded nature of LGPS creates different implementation risks from the other schemes and therefore different implementation strategies may be required.

The Chancellor of the Exchequer announced in the Budget that the Government fully accepts the Commission's report and will begin the process of negotiation on implementation later this year.