Appendix 'B'

Richard McDonagh

The LGPS Pension Team

5/G6

Department for Communities and Local Government

Eland House

Bressenden Place

LONDON

SW1E 5DU

Dear sir,

Consultation on Proposed Increases to Employee Contribution Rates and Changes to Scheme Accrual Rates Effective from 1st April 2012 in England and Wales

This response to the above consultation is made on behalf of the Pension Fund Committee of the Lancashire County Pension Fund. The Fund is one of the largest local government pension funds with 134,000 members and assets of £4.3bn at the end of March 2011. A separate response to this consultation will be made by Lancashire County Council in its capacity as a scheme employer.

Fundamentally we consider that this consultation exercise starts from the wrong premise. The consultation directly connects reductions in the cost of the Local Government Pension Scheme (LGPS), with the Government's deficit reduction plan as set out in the Comprehensive Spending Review. This is, to say the least, disingenuous. LGPS Funds, are just that funds, they are stores of assets set aside to meet future liabilities. All contributions whether from employer or employee are paid into the funds, which are administered by committees with a quasi trustee status which obliges them to act in the interests of the ongoing solvency of the individual Fund.

All English and Welsh funds have a deficit following the 2010 valuation., Given the current ongoing economic challenge, the turmoil in the financial markets, and the impact of the increase in gilt yields on liabilities, the position of all LGPS funds will have worsened. The over-riding fiduciary duty of Fund Committees is to ensure that Fund deficits are reduced while maintaining stability in employer contributions rather than trading increased employee contributions for reduced employer contributions.

As a result there will be no impact of these proposals on the overall public sector deficit. In these circumstances members of the LGPS would be forgiven for thinking

that they are being penalised for the fact that they and their employers have over many years acted prudently by operating a properly funded pension scheme which also as a by product provides significant support to the UK economy.

We also feel it is misleading to suggest that the only way in which scheme members will pay more for their pension is through directly increasing contribution rates. Changing the accrual rate means that the price of each £ of pension ultimately received is increased. Thus in order to achieve a pension of the same value scheme members will have to pay more.

We would suggest that the fundamental issues now being faced by LGPS could have been addressed had the changes in 2008 not proceeded. The move from an accrual rate of 1/80th to 1/60th has been costly for funds in terms of increasing their long term liabilities, with consequent impact on employer contributions which has been masked in the latest valuation by the impact of the move to the CPI inflation assumption.

A fundamental issue with any change to LGPS in the current economic context is the impact of any changes on opt out rates within the LGPS. These are already higher than in other public sector schemes. Participation in the scheme is already being affected by workforce reductions while the ongoing pay freeze for local government staff is undoubtedly affecting the affordability of membership for some lower paid workers. This pressure on participation will continue into the future as changes such as tuition fees impact on key groups within the core local government workforce. Thus any proposal which directly increases employee contributions which are already higher in LGPS than in other schemes at an average of 6.5% (compared to the 1.5% - 3.5% in the civil service and the 1.8% to 2.4% for judges) runs the risk of increasing opt out rates which already present a significant risk for funds.

To press home this point; a reduction in member numbers of perhaps 10% might well be enough to put the Lancashire County Pension Fund into a cash flow negative position. It is, however, possible to alter the benefit structure to provide decent pensions for scheme members without increasing contribution rates, and still make an impact on the overall deficit within funds. We believe that this is a better approach to managing the issue than the approach taken by either the Government or the Local Government Association in their proposals. Our consulting actuary has estimated that for the Lancashire County Pension Fund (which is not untypical of LGPS funds generally) changes to the accrual rate could result in the following changes in employer contributions:, assuming that deficit recovery contributions remain unchanged, although this is not necessarily a course we would advocate, preferring instead to accelerate deficit recovery as employers have already budgeted for these contributions:

	1/60th Scheme % of Pay	1/70th Scheme % of Pay	1/80th Scheme % of Pay
Future Service Contributions	12.5%	9.9%	7.9%
Deficit Recovery Contributions	6.6%	6.6%	6.6%
Total Employer Rate	19.1%	16.5%	14.5%

This analysis assumes that deficit recovery contributions remain unchanged, and instead savings are passed to employers. We provide this analysis for comparison only with the proposals, as deficit recovery is a critical objective of LGPS funds.

Moving to an accrual rate of 1/70ths would reduce the employers' contribution from almost 3 times the employees' to about 2.5 times or 2.2 times, without immediately impacting on scheme members, thus reducing the risk of opt out to the maximum extent possible, while maintaining a benefit package that would still be much better than the average achievable through private provision. We would estimate that on its own such a change would achieve about 90% of the £900m "savings" targeted by the Government.

While this is our preferred option for achieving the "savings" being sought by ministers we suspect that any option which does not include some increase in employee contributions is unlikely to find favour. Given this we have therefore asked our consulting actuary to work up costings around an alternative to the various options canvassed in the consultation document. Our reasoning for this is founded on a number of key concerns with the proposals made by both CLG and the LGA:

- There is no logic to increasing the scheme's normal retirement age to 66 ahead of the increase in the state pension age, and this might significantly disrupt retirement planning for members affected by the cliff edge effect.
- The option proposed by the LGA of allowing members to choose between increased contributions and reduced accrual creates significant administrative complexities and potentially additional administrative costs. In addition scheme members will need to secure advice on the best course for them in their particular circumstances and there are significant risks of members taking decisions without access to appropriate advice.
- The CLG proposal of phasing a reduction in accrual will in effect create a further temporary one year scheme which is administratively complex and will needlessly increase the complexity and cost of computer systems.

Consequently we would support a proposition that LGPS move to a reduced accrual rate from April 2013. This would allow there to be some reduction in the amount required to be raised through employee contributions to achieve the £900m target. Given that CLG's approach 1 already protects the lowest paid we would support using some of the headroom generated by this change to reduce the impact of increased contributions for those in the £21,000 to £40,000 income bands, which is

the area where the risk of increased opt outs is greatest. We do, however, recognise that this group represents a substantial part of the membership, which in itself limits what we can suggest, if the proposals are to remain within the government's cost framework.

It is clear that there are no easy solutions in terms of the shorter term changes proposed by the Government in order to realise savings in the cost of public sector pensions. From the point of view of Lancashire County Pension Fund, as opposed to any employer, the following represents the key points of our response. Two alternative proposals worked up with the assistance of the Fund's actuary are set out at Annex A to this letter.

1. The fact that Funds are operating with deficits must be recognised and any reduction in employer contributions should not take place until the next valuation.
2. Any proposals for change from April 2012 need to be focussed on minimising the potential for increased levels of opt out from the scheme.
3. The strong preference of the Fund would be for a series of changes which do not require increases in employee contributions which at the current level are already higher than in many public sector schemes where average member earnings are higher than in LGPS.
4. Given that Ministers are likely to view options which do not increase employee contributions unfavourably, a proposal which balances all of these objectives would be to make changes to accrual rates from April 2013 with any accompanying increase in employee contributions structured so as to protect the lowest paid.
5. Some of the additional "savings" from an earlier move to a reduced accrual rate accrual should be used to reduce the degree of increase in employee contributions for members earning in the range £21,000 to £40.000, which is the group where the risk of further opt outs seems most likely.
6. Any proposals for change from April 2012 need to be administratively deliverable

We are keen to explore this alternative proposal with you and your colleagues and would relish such an opportunity to discuss this approach.

Yours Sincerely

Gill Kilpatrick

Treasurer to the Lancashire County Pension Fund