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Dear Colleague

SUSTAINING THE LOCAL GOVERNMENT PENSION SCHEME IN ENGLAND AND WALES

1. I attach, with Ministers' agreement, draft proposals for further amendments to the Local Government Pension Scheme (LGPS) Regulations as set out below. It is intended that these Regulations would take effect from 1 April 2009.
2. Responses to this statutory consultation exercise are now invited by **23 January 2009**. The next step will be to proceed to the making and laying of regulations as soon as possible thereafter with an effective date of 1st April 2009.

Introduction

3. Communities and Local Government (CLG) is committed to the introduction of a cost sharing mechanism for the LGPS in England and Wales, by 31 March 2009. In order to take this commitment forward, CLG carried out an informal consultation to seek the views of stakeholders on '*Sustaining The Local Government Pension Scheme*'. This exercise closed on 30 May 2008. The initial analysis of response received indicates a broad consensus among interested parties on the principle of cost sharing.

4. The summary of that informal consultation exercise was placed on the CLG website at www.xoq83.dial.pipex.com. This paper takes into account not only the constructive recommendations received from respondees to the recent informal consultation exercise, but a further consideration of key issues from recent Policy Review Group and subsequent bilateral meetings with the key interested parties.

The policy context

5. The Government's policy objective for the Local Government Pension Scheme is for it to remain affordable, viable and fair to all – employees, employers and taxpayers. This

objective is shared by stakeholders across the Scheme and, in policy terms, it continues to provide a clear context for on-going Scheme reforms and amendments.

6. In his Statement to Parliament on 23 November 2006, (Hansard Official Record 70WS, 71WS and 72WS) the then Local Government Minister, Phil Woolas MP, confirmed the continued provision of good quality pensions for the local government workforce, and other employees eligible for LGPS membership, through benefits provided by an equality-proofed, final salary, pension framework:

The regulatory context

7. The regulations outlining the new-look Local Government Pension Scheme (LGPS), the *Local Government Pension Scheme (Benefits, Membership and Contributions) 2007 Regulations* (SI 2007/1166) came into effect on 1 April 2008. These deliver on the Government's promise that the new-look Local Government Pension Scheme be affordable, viable, and fair to tax-payers who ensure its continued security and stability.

8. The cost-share arrangements when finally introduced are intended to both inform, and take account of future actuarial valuation exercises for the Scheme. The new arrangements are intended to be in place, therefore, when individual fund actuaries consider new employer contribution rates following each fund's valuation. Similarly, the outcomes of the future valuation exercises will need to be reflected in final decisions on the form and content of the cost-share arrangements themselves and how they will impact in turn on successive valuations.

Consultation Draft Statutory Instrument

9. The draft Statutory Instrument which is the subject of this formal consultation phase of the process of introducing cost sharing arrangements is attached at **Annex A**. As we have already consulted on and considered the policy implications of moving forward on a cost sharing process to ensure the ongoing sustainability of the LGPS, views are now sought on the applicability of the regulatory provisions rather than re-examining in detail policy issues and the administrative process which will follow the adoption of the proposed approach.

10. The nature of responses to the consultation and our discussions with the PRG indicate that progress needs to be made incrementally to ensure both full understanding of the longer term aim of maintaining a sustainable defined benefit pension scheme and, more pertinently, the results of any data collecting and modelling. This is of particular importance when decisions made will influence the future design of the overall benefit package or the cost which members may be required to bear in providing an affordable and viable defined benefit pension arrangement going forward.

11. The SI concentrates on key points where it is felt a regulatory framework is essential, and introduces regulations which

- Delete current regulation 40 of the LGPS (Benefits etc) Regulations which required guidance to be provided by 31 March 2009;

and replace this with requirement that

- Authorities have regard to guidance on how future costs will be met [36A(1)]
- Administering Authorities provide the S of S with the financial and other data by 31st July 2010 to enable the future service cost of the scheme to be calculated [36A (2)];
- GAD carry out actuarial valuation of combined English and Welsh funds, and produce an overall future service cost certificate for the Scheme by 31st December 2010, which sets out cost of future accrual of pension liabilities for next triennium [36A (3) and (5)];
- The valuation leading to the production of this certificate must set out the assumptions used [(36A (4) and (6)].

12. The purpose of these provisions is to pave the way for the establishment of a national model fund to be used by the Secretary of State for determining benchmark and overall costs of the LGPS going forward. It may be helpful for consultees to look at the illustrative examples prepared by the GAD on cost-sharing and cost-capping at **Annex B**.

13. The regulation will put in place a duty on funds to provide to CLG the same data made available to their actuary as at the 2010 and subsequent actuarial valuations. This is seen as essential in order to ensure that the data to be used in modelling represents 100% of the Scheme's membership. In previous evidence gathering exercise the obligation was not present and it led to degrees of uncertainty in the selection methods used and the resultant extrapolations. This should remove that hurdle and the scope for ultimately fruitless discussions on the validity of available data sets.

14. The regulation also sets out specific milestones and the timetable within which all the specified parties must comply in order for the Secretary of State to establish a model fund which will be the tool used to benchmark the Scheme costs relative to future service accrual. The regulatory timetable imposes a transparent framework and discipline within which we must all operate. It also recognises the important statutory responsibility of the Secretary of State in operating as the regulator and administrator/trustee of the Scheme.

15. It is envisaged that the guidance that will flow from the modelling exercise and ongoing consultations with the parties about the assumptions to be used, could, subject to Ministerial approval, establish a series of "traffic light warnings", the parameters within which the cost sharing mechanism will operate and the triggers for taking action. This approach specifically excludes an overly simplistic formulaic approach to triggering of cost sharing processes, and recognises the very nature of the LGPS and the extent to which all interested parties be given the opportunity to be actively involved in the future decision making processes. Working from the establishment of a baseline benchmark cost, which will be an intrinsic part of any national model, those interested parties with whom the Secretary of State will consult further will play an active role in monitoring and handling any fine tuning which will be an essential part of maintaining the ongoing stability and sustainability of the pension scheme at future actuarial valuations. In practical terms this may need to be a designated group, which will have to act with due regard to realistic timetabling set out in the proposed regulation.

16. In the worst cases, and based on validated evidence of trends within the scheme, there may need to be action to either amend the overall benefit package or vary contribution rates and overall employee contribution yields. At another extreme, decisions would need to be taken on whether it would be prudent in the short term to reduce contribution yields or consider improvements to the benefits package. However, if agreement cannot be reached decisions will need to be considered in the interest of members and beneficiaries but with due regard to external parties who contribute to the cost of the LGPS.

A Dry Run - Autumn 2008

17. The PRG meeting on 3rd July 2008 considered the initial results of the informal consultation exercise. It was agreed that to assist in a full understanding of what is being proposed then it would be helpful that alongside the first stages of an incremental approach, put in place by this statutory consultation, it would be helpful to all interested parties to carry out a dry run to construct a model fund based on the 2007 actuarial valuation data. This dry run is to operate in parallel with this statutory consultation and would then inform both the PRG and ultimately Ministers and all interested parties of issues to be considered, problems to be tackled and the communication strategies required once the statutory framework is in place.

18. All administering authorities have already been asked to release their 2007 actuarial valuation data through their actuaries for the Government Actuary's Department to carry out the dry run. The actuaries (subject to agreement of clients) have provided data in line with specifications agreed with the Government Actuary's Department, using previously cleansed data covering the aggregate of all LGPS fund liabilities in England and Wales.

19. From the outcomes of the dry run the PRG will evaluate the structure and risk elements that are included in the national model. The dry run will also provide the opportunity to test varying sensitivities, leading to better understanding of the structure and function of the eventual national fund.

Responses to the Consultation

20. Please send your responses to the this consultation and in particular the draft Statutory Instrument to Divya Patel, Workforce Pay and Pensions 2, 5th Floor, Eland House, Bressenden Place, London SW1E 5DU (email: Divya.Patel@communities.gsi.gov.uk) no later 23rd January 2009.

21. If you have any queries concerning the consultation, please contact Brian Town as above.

Yours sincerely

Brian Town
**Communities and Local Government
Workforce Pay and Pensions 2**

