Ministry of Housing,
Communities &
Local Government

Consultees as at Annex A:

Date: 28 March 2018

Dear Sir/Madam

Local Government Pension Scheme: Consultation on the Implementation of new Late Retirement Factors

Background

1. The Secretary of State for Housing, Communities and Local Government is required to issue actuarial guidance on late retirement increases to benefits payable after normal pension age. We do not normally consult on the content of actuarial guidance notes but in this instance we intend to do so because we are proposing a significant change to the methodology by which late retirement factors are calculated. We are also aware that these are factors that act as a multiplier for a member's accrued benefits and so tend to be the subject of great scrutiny and interest by members and their representatives. It is not our intention to consult on the other guidance notes when these are revised later this year.

2. The last revision of late retirement factors in 2017, and the communication of it to affected members, attracted some criticism at the time. Consequently, the then Local Government Minister, Marcus Jones MP, asked the Scheme Advisory Board (SAB) to look again at the way late retirement factors are calculated and implemented.

3. Following consultation with the SAB and the Government Actuary's Department (GAD), the Department would like to carry out a short, technical consultation on the content of the attached guidance note and our plans for implementation of the new factors. Also attached are some illustrations from GAD of how the proposed new factors compare with the current factors which apply.

4. Consultees are invited to respond before 4pm on Wednesday 17 April. Consultation responses will inform the final recommendations that we will put to our Minister in due course.

Removing the Cliff Edge

5. A shared objective of the Department and SAB was to remove the "cliff edge" when factors change. When the factors last changed in January 2017 there was a significant and immediate reduction in the uplift that became payable to those who had worked past pension age. We agreed to move to an approach which was more consistent with the scheme's current CARE design and gave a smoother transition between factors.

Ministry of Housing, Communities and Local Government
Local Government Finance Reform and Pensions
NE Quarter, 2nd Floor
Fry Building, 2 Marsham Street
London
SW1P 4DF

LGPensions@communities.gov.uk

6. Under the new approach, the period worked past normal retirement age is divided into the periods prior and post the introduction of the new factors. The increase for the former is calculated on the current factors and method, and that for the latter on the new factors. This results in a smoother transition between one set of factors and the next for individual members. The attached draft guidance note includes some worked examples to illustrate how this applies in practice.

   Q1. Consultees are invited to comment on whether the proposed methodology achieves the aim of smoothing the impact of changes in factors?

Other policy choices in methodological approach

7. During the course of our discussions, representations were made from member representatives that the use of short term pay assumptions in the calculation of LRFs would be more appropriate. These arguments claimed that the longer-term assumptions included salary growth in excess of raises that have been seen in local government recently. It was also asserted that as periods of service past pension age tended to be short then it was unlikely that those staying on would receive further significant increases in pay.

8. Short-term assumptions would, by their very nature, have a short shelf life. This would mean that they, and the factors derived from them, would need frequent re-calculating. That would run counter to our main policy intent, which is to provide greater certainty to members in their retirement planning, as well as increasing administrative costs.

9. Further, it is the change in difference between the salary growth assumption and the discount rate used that the late retirement factor is sensitive to, rather than the salary growth assumption in isolation. It was change in this differential which drove the change in factors in January 2017. For LGPS factors the discount rate currently adopted is the HMT SCAPE rate, which is based on the long term forecast of GDP growth.

10. If we were to move to shorter-term assumptions then we would need these both for the salary growth and SCAPE rate assumptions. These assumptions are expected to move largely in tandem, but not necessarily in a perfectly synchronised way. Hence switching to short term financial assumptions could simply lead to factors progressing through a cycle of rises and falls, due to the relative timing of cyclical changes in earnings and GDP. This would increase volatility in the factors and uncertainty for members, which is against our policy intent.

    Q2. Consultees are invited to comment on this approach and provide any evidence which supports their view?

Implementing the new approach and factors

11. It is proposed that the guidance note will apply to all retirements from 1 May 2019. The new factors differ slightly from the old ones, with some members seeing an increase in their uplift while others see a slight decrease. However, these differences will be smoothed by the new methodology that has removed the cliff-edge effect of any change.

12. We do not intend to recommend that this methodology be backdated. Members leaving under the old factors did so on a basis that was, on the best evidence available

at the time, actuarially neutral. At the point in time at which they retired the factor applied to them was appropriate and fair. While we are aware of some hard cases that arose because of poor communication of the change in 2017, we believe that these should be addressed by funds on a case-by-case basis. Retrospective and gratuitous changes to benefits are not in the interests of scheme employers, administrators and most importantly other scheme members.

Q3. Consultees are invited to comment on the proposed implementation of the new late retirement factors.

Yours sincerely,

S J Clarke

Suzanne Clarke
Deputy Director, Local Government Finance Reform and Pensions Division

Annex A: List of Consultees

Scheme Advisory Board	Jeff.Houston@local.gov.uk
Local Government Pensions Committee	Lorraine.Bennett@local.gov.uk and Jayne.Wiberg@local.gov.uk,
LGPS Administering Authorities	On circulation by LGPC
LGPS Technical Working Group	KGerard@carmarthenshire.gov.uk
Devolved Administrations	Jack.Davies@walesoffice.gov.uk Amanda.Whittle@gov.wales Kimberly.Linge@gov.scot zena.kee@nilgosc.org.uk and siobhan.mckelvey@communities-ni.gov.uk
Pensions Officers for those trade unions representing scheme members: GMB, UNISON and UNITE	George.Georgiou@gmb.org.uk, g.jenkins@unison.co.uk and j.richards@unison.co.uk Jim.Kennedy@unitetheunion.org
The Scheme Actuaries: Barnett Waddingham, AON, Mercer and Hymans Robertson.	Graeme.Muir@Barnett-Waddingham.co.uk Melanie.Stephenson@Barnett-Waddingham.co.uk, alison.murray@aon.com becky.durran@aon.com John.Livesey@mercer.com Paul.Middleman@mercer.com, Robert.Bilton@hymans.co.uk Catherine.McFadyen@hymans.co.uk