Freedom and Choice in Pensions Consultation
Pensions and Savings Team
HM Treasury
1 Horse Guards Road
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To whom it concerns,

I set out the Local Government Association's (LGA's) response to the Government's consultation document *Freedom and Choice in Pensions* published in March 2014.

In the LGA's role as a representative body of local government in the UK, this response specifically concerns aspects of the pension reforms which will impact on the Local Government Pension Scheme (LGPS).

Background

The LGPS is a defined benefit public service pension scheme that is distinguished from other public service pension schemes such as the civil service schemes, the Teachers' Pension Scheme and the NHS Pension Scheme by the fact pension benefits in the LGPS are paid through a pension fund maintained by each LGPS administering authority.

Chapter 5 of *Freedom and Choice in Pensions* addresses the implications for the Budget reforms on defined benefit schemes, and the options open to the Government in consideration of those implications. In specific regard to public service pension schemes the document states in paragraphs 5.4 to 5.7 the Government's intention to introduce legislation which would limit transfers from public service pension schemes to defined contribution (DC) schemes, except in 'very limited circumstances'. This desire to limit transfers is borne out of concern that the expected increase in demand for transfers to DC schemes will have a negative impact on the public purse, as transfers from the unfunded public service schemes are funded directly from the Exchequer.

Potential positive funding impact

Whilst recognising the Government's preference for the funded and unfunded public service pension schemes to be treated consistently (paragraph 5.7) a distinction could be drawn between a) the possible impacts on the LGPS of an increased number of transfers to DC schemes from b) the possible impacts on the unfunded public service pension schemes.

An increased number of transfer payments to DC schemes from the LGPS would not cause an additional cash burden for the State as these would be paid by the individual pension funds. In the short term, these pension funds may find an increase in external cashflows as outward transfer payments increase. However, with the transfer of pension obligations elsewhere, the reduction in the number of promised benefits payable by the LGPS could cause a decline in the long term costs of the Scheme, as the Scheme would be less exposed to long term unknowns such as longevity improvements in excess of current estimations.

Looked at from a Scheme perspective, continuing to allow transfers from the Local Government Pension Scheme to DC schemes could therefore have a positive financial impact in the longer run, and decrease the likelihood of future pressure to reform the Scheme benefits structure.

Considerations
However, whilst there would be possible financial benefits for the Scheme of allowing transfers to DC schemes from the LGPS, there are considerations which this would need to be weighed against.

1) **Member risk**

Defined benefit schemes typically provide pension scheme members with a greater level of security than DC schemes, and public service pension schemes provide a particularly high level of security to their pension scheme members. Additionally, beyond concerns of security, the LGPS remains a premium scheme in terms of the benefits it offers to its members. In the majority of cases, it would not be in the financial interests of LGPS scheme members to transfer their benefits to a DC scheme. Indeed, allowing such transfers would leave open the risk of mis-selling, and the possibility of a scandal similar to that of the late 1980s occurring.

Additionally, Scheme reforms implemented in April 2014 already make it less likely that a Scheme member would find it desirable to transfer to a DC scheme. Prior to April 2014, the earliest an LGPS member could voluntarily choose to take their retirements benefits without the consent of their employer was from age 60, whereas in DC schemes the lower limit was and is 55. Part of the attraction of transferring to DC schemes was therefore the ability for members to freely access their benefits at a point between their 55th and 60th birthdays. However, under the new LGPS benefits structure, LGPS members with accrued benefits from April 2014 can now voluntarily retire from 55 without their employer's consent. This reduces the attractiveness to such members of transferring their benefits to DC schemes, and preventing transfers would in this respect therefore not restrict the freedom and flexibility LGPS members have in accessing their benefits.

2) **Pensions liberation**

A great deal of work has been undertaken in recent years to combat arrangements which claim to be able to 'liberate' people's pensions prior to the point in time they would ordinarily be able to access these rights under HMRC and/ or pension scheme rules.

An outright ban of transfers to DC schemes from defined benefit pension schemes including the LGPS would go a long way to ensuring pension liberation schemes become a thing of the past. This would be a welcome side effect of the reforms if the determination is made that transfers could not be made from public service pension schemes, or more widely from all defined benefit pension schemes, to DC schemes.

Prohibition of transfers to DC schemes
The consultation document states in its foreword the Government's view that '*the State should not be imposing restrictions on individuals who have made tough choices to save for the future'.* Certainly, the LGPS's funded basis means that this freedom could be achieved for LGPS members via transfers to DC schemes, and increased freedom could be beneficial for the long term health of the Scheme if members were to take up this opportunity.

However, on balance with the considerations set out, LGA believe that the potential financial detriment for members of transferring their benefits to DC schemes, and the linked risk that a mis-selling scandal similar to that of the 1980s could therefore occur if such transfers are permitted under the new framework, suggest that, overall, transfers from the LGPS to DC schemes should not be permitted upon the introduction of the new legislative framework in April 2015. The LGA believe instead that the Government look further in to methods through which LGPS members could access their benefits more flexibly from within the Scheme itself. Possible methods for achieving increased flexibility are set out in the below section.

Alternative methods for achieving increased flexibility
Recognising the Government's stated aim for more freedom and choice in pensions, increased flexibility could be achieved in the LGPS via other means. These alternatives would have the advantage of continuing to provide security for Scheme members via the basic Scheme structure

whilst allowing for increased scope for members to make their own choices regarding their retirement benefits.

Under additional voluntary contributions (AVC) contracts entered into from 1st April 2014, LGPS members can access up to 25% of their accrued pots via tax free lump sum. The remainder of members' AVC pots can be used to purchase taxable pension income. AVC contracts provide benefits on a money purchase basis and are not held with the main Scheme benefits in the pension fund, but are invested with a third party provider. They are thus more akin to normal DC benefits purchased in the private sector than to the main Scheme benefits. We can therefore see an argument for an extension of the freedoms being granted to those with DC pensions from April 2015 to those holding AVC contracts in the LGPS.

In addition, under the LGPS Regulations 2013, a member taking their benefits can choose to commute some of their annual pension to a lump sum payment up to a maximum of 25% of their accrued LGPS pension rights. A measure of increased flexibility could be allowed for by increasing the proportion members can commute to lump sum. An increased commutation limit would also have the positive effect for the Scheme of reducing the future obligations payable by the pension fund.

Earlier in this response, I referred to the fact that LGPS members in England and Wales can access their retirement benefits from the age of 55 under the new LGPS benefits structure. This is currently only applicable to those members who have accrued membership in the LGPS after 31st March 2014. Those members with preserved benefits from prior to April 2014 can currently only access their benefits from the age of 60. A further element of flexibility could be introduced by the Department for Communities and Local Government amending the regulations governing the pre April 2014 Schemes to allow these members the option of electing to draw their benefits from the age of 55, with appropriate actuarial reductions applied. This would create for greater consistency between pre and post April 2014 LGPS deferred scheme members and the application of reductions would ensure that this would be achieved on a cost neutral basis. It would also ensure that no members in this category who might wish to transfer their benefits to a DC scheme to access their benefits from the age of 55 would be detrimentally affected by the decision to ban transfers to these schemes from the LGPS.

Minimum Pension Age

Question 5 of the consultation document asks whether the minimum pension age should be increased further, for example so that this is only ever five years below the state pension age (SPA).

It is the LGA's view that a further narrowing from the proposed minimum pension age of ten years below the SPA should not be considered at this point. Scheme reforms, as negotiated and agreed between Scheme employer and Scheme member representatives, have been implemented in the LGPS in England and Wales to create a sustainable Scheme structure for the next 25 years, and a narrowing of the minimum pension age to just five years below the SPA at this point would represent a significant departure from the agreed reforms so soon after they have become effective. In practical terms, a five year gap would mean that by 2028 the minimum pension age in the LGPS would be 62, five years below the SPA of 67. Over just 14 years, this would be an increase in seven years from the current minimum pension age in the LGPS of 55.

Furthermore, the provision for members to retire at a point below their normal pension age is cost neutral for the Scheme, as it is either funded by actuarial reductions to members' pensions or by a cash injection from the employer. It seems to us that a further narrowing of the gap between minimum pension age and the SPA would stand in contrast to the stated aim for freedom and choice in pensions, particularly given that this flexibility is granted in a cost neutral manner.

Public sector transfer club

Finally, the LGA believe that reform of transfer legislation is an opportunity to review the basis of transfers between public service schemes which are currently calculated using agreed 'transfer club' terms. This is particularly in light of the reforms which are currently underway in the public service schemes as these each move from a final salary to a career average basis.

Yours sincerely

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