London Pensions Fund Authority (LPFA)
Response to consultation
17 August 2021

Public Service Pensions: cost control mechanism consultation
Proposal to reform the mechanism

Introduction

This response is provided by London Pensions Fund Authority (LPFA). LPFA is responding to this consultation in its capacity as an Administering Authority for the Local Government Pension Scheme (LGPS). LPFA is also a Scheme Employer within the LGPS.

LPFA does not have a view on the level at which public service pension benefits are set. It is our understanding that the proposals are not expected to result in a systematic increase or decrease in the potential future level of LGPS benefits.

The responses set out below are considered from the perspective of their impact on the potential administrative complexity of the LGPS.

In summary, LPFA is supportive of the proposals, except to note that the use of the SCAPE rate for assessing the cost of benefits in the LGPS risks potentially undesirable outcomes.

Question 1: Do you agree that a reformed scheme only design would achieve the right balance of risk between scheme members and the Exchequer (and by extension the taxpayer), and would create a more stable mechanism?

Answer 1: LPFA strongly supports this proposal.

The current approach of including salary-related benefits within the cost control calculation could result in intergenerational unfairness. Our opinion is that it is sensible to align the benefits being assessed and those potentially being reformed. This approach would reduce the scope for intergenerational unfairness to emerge.

Question 2: Do you agree with the Government's intention to widen the corridor? If not, why not?

Answer 2: LPFA supports this proposal.

We understand that the proposal is intended to be "symmetrical", to neither favour the scheme members nor the taxpayer. The use of a wider corridor would be expected to reduce the frequency of any changes to future service benefits. As an Administering Authority, an approach that results in less frequent changes to benefits is preferable, as it reduces the administrative and communication burden associated with such projects, which can be considerable.

We note that estimates of the frequency with which the corridor might be breached (for example once every 20 or 40 years) are based on models that carry a high degree of uncertainty both in the explicit and implicit assumptions. We therefore do not regard such estimates as helpful when considering the proposed changes to the mechanism.

Question 3: Do you think that a corridor size of +/-3% of pensionable pay is appropriate? If not, why not?

Answer 3: LPFA supports this proposal.

We note that the choice of corridor width reflects a balance between competing objectives to control costs and not to amend benefits excessively frequently. As an Administering Authority, not amending benefits excessively frequently represents a more pressing objective for LPFA. We therefore support a wider rather than a narrower corridor. The choice of 3% appears to be reasonable, but LPFA does not have a strong view on precisely where the edges of the corridor should be set.

Question 4: Do you agree with the proposal to introduce an economic check?

Answer 4: LPFA strongly supports this proposal.

An economic check makes sense and will help avoid results such as those seen in the preliminary 2016 results where no factors linked to the change in economic growth were considered. This would work best as a separate check as currently proposed rather than worked into the current cost control calculations, especially as this could lead to volatile results which the mechanism aims to avoid.

The proposed economic check provides a clear way to assess whether the outcome of the initial cost control calculation is appropriate.

Question 5: Do you think that the SCAPE discount rate, as it currently stands, is an appropriate economic measure for the cost control mechanism?

Answer 5: LPFA is not supportive of this proposal for the LGPS.

The use of the SCAPE rate to assess the cost control mechanism and the economic check is understandable for those public sector schemes that use the SCAPE rate to set contributions. This approach ensures that the assessment of the cost control mechanism is consistent with the contributions being paid by employers and members.

By contrast, contribution rates for the LGPS are set using assumptions set by each Fund's actuary with reference to the prospective return on assets held in the Fund. Under the previous cost control methodology (i.e. without an economic check) the choice of discount rate was not a significant determinant of the outcome. However, under the proposed approach the choice of discount rate could have a significant effect on whether the corridor is breached.

The proposed misalignment between the discount rates used to set contributions and to assess the economic check results in the potential for undesirable outcomes. For example, it is entirely possible for the SCAPE rate to increase at a time when LGPS discount rates are falling. In this situation the cost control mechanism could result in benefit improvements at a time when contributions are increasing.

In our view, the cost control mechanism for the LGPS should be based on a discount rate that maintains some link to the discount rate adopted for contribution setting purposes. For example, the average discount rate from the most recent LGPS funding valuation could be used.

Question 6: If the SCAPE methodology changes, and the Government considers that the SCAPE discount rate is therefore not an appropriate measure for the cost control mechanism, then do you think that a measure of expected long-term GDP should be used instead? If not, please set out any alternative measures that may be appropriate in this scenario. Please consider in the context of the separate review of the SCAPE methodology currently being undertaken by HM Treasury.

Answer 6: LPFA is not supportive of this proposal for the LGPS.

As noted in our response to question 5, in our view the cost control mechanism for the LGPS should be based on a discount rate that maintains some link to the discount rate adopted for contribution setting purposes.

Question 7: Do you envisage any equalities impacts from the proposals to reform the cost control mechanism that the Government should take account of?

Answer 7: As the proposed reform would apply to all benefits accrued in future, we do not see any obvious equalities impacts. Any future proposed benefit changes should still be reviewed as normal to ensure that they do not cause any inequalities.